A7000-1
11/18/88

REAL ESTATE

Vol. 1, No. 11

OUTLOOK

November 1988

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The U.S. Commerce Department reported that the pace of economic growth, as measured by the inflation-adjusted Gross National Product, slowed during the third quarter to an annual rate of 2.2 percent, the slowest pace since the fourth quarter of 1986. Actually, the economy is much healthier than the recent GNP reports suggest, and the potential for rising rates of inflation remains strong.
- This slower growth report was accompanied by news that inflation (as measured by the GNP price index) reached an annual rate of 4.9 percent in the third quarter, virtually unchanged from the 5.0 percent rate of the second quarter.
- The monthly fluctuations in the trade deficit continue to cloud the issue of whether the U.S. merchandise trade balance is improving. The most recent data shows that the August U.S. trade deficit widened to $10.6 billion from $8 billion in July.
- The path of long-term interest rates, including those on fixed rate mortgages is expected to trend upward slightly through the first half of 1989. The economy will continue to expand through 1989, but as it does, wage and price pressures will increase. Mortgage interest rates are expected to creep above 11 percent before trending back down in mid-1989.
- Total starts of privately owned housing units reached a seasonally adjusted annual rate of 1.453 million units in September, 1.5 percent above August's rate of 1.431 million units, Starts of multi-family units rose 13.2 percent in September to an annual rate of 403,000 units. Single-family housing starts fell 2.3 percent in September to a seasonally adjusted annual rate of 1.05 million units. Housing starts are expected to hold steady through the rest of 1988 before slowing considerably next year, totalling 1.467 million units this year and 1.375 in 1989.
- Sales of existing single-family homes fell 2.2 percent in September to a seasonally adjusted annual rate of 3.63 million units. September's sales were up 5.8 percent from last September when existing homes were sold at a seasonally adjusted annual rate of 3.43 million units. For the first three quarters of 1988, existing home sales totaled 2.771 million units, just slightly above the 2.768 million units sold during the first nine months of 1987.

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AN OPEN LETTER:

Economic Commentary

by
John A. Tuccillo
Chief Economist and
Senior Vice President
Real Estate Finance

Dear Mr. President:

Forgive my presumption in writing you, especially now in the hour of your triumph, to offer some thoughts on the economic future of the country. I know you have surrounded yourself with a dazzling array of economic talent, and I'm just a garden variety, trade association economist, but maybe a view from the outside can be useful. I don't have any specific plans to close the budget deficit or solve the thrift crisis, but I can suggest the overriding themes that must characterize the economic policies of your administration if you are to be successful. Now some of this may be a bit strong, but as Jim Hightower (the head of the Texas Department of Agriculture) notes, "The only things in the middle of the road are yellow lines and dead armadillos." So here goes.

1.*The 1990s begin with you.* For better or worse, the Reagan era is over, and you are really the first president of the Nineties. More importantly, you have virtually no control over the economy of 1989. The year will be one of slower, but positive growth against a background of stable inflation and interest rates that will move within a relatively tight band. So, let the Federal Reserve manage 1989 and think about the nineties and beyond. Concentrate on how we can use this economic expansion to make the investments in physical and human capital we need to make in order to enter the twenty-first century a resurgent power. Look to promote savings and find ways to channel those savings into productivity -- not into consumption, not into corporate takeovers and mergers.

2. *Make tough choices early*. You will be the beneficiary of an automatic (and illusory) improvement in just about every major problem facing this country. The growth in the Social Security trust fund will gradually wipe out the Federal deficit and may even soak up the national debt. Don't believe it. Make the real and permanent cuts in the deficit that will ultimately place the public fisc in order to reform the military procurement and pension systems to save money without sapping strength; use lower oil prices to raise revenue through an oil imports tax; look hard at all entitlements. But don't look at a falling budget deficit, a falling trade deficit and a growing savings rate and pronounce the world well and safe. Make the tough decisions and manage your good fortune into even more good fortune.

3.*Care a great deal about the financial system*. The thrift problem must have a systemic solution. Throwing money at the problem may clean up the current mess, but will do little to eliminate the causes. We are overbanked as a nation. If oil had stayed at $40 a barrel, and the Texas debacle had never hit the industry, we would still be witnessing a sharp reduction in the number of thrifts and banks. Yes, solve the thrift crisis as quickly as you can. But seek a solution that will allow for the *orderly* winding down of an industry where there are just flat-out too many firms.

4. *Listen to the people.* We've spent twenty years learning that top-down solutions can only skim the surface of national problems. In so many cases -- housing, education, infrastructure -- problems are local and solutions need to originate there. The Federal government is a marvelous amasser and distributor of resources and information, but a dismal administrator of local-level programs. Stand up and say this publicly and then act on it. Find out how local governments, firms and individuals are getting things done and then funnel resources and information to the local level so it happens everywhere. You were elected by appealing to 50 different states where your tactics and message were tailored to local conditions. Run national economic policy the same way.

Well, that's my contribution. I think you face a difficult and exciting four years. There will be at least one recession before 1992; foreign investors will continue to buy stakes in America; the Federal deficit and the thrift problem must be worked through. But the fundamental strengths of the economy and the structure of the population will provide a strong and favorable background against which to deal with the problems. Good luck. The prospects are good, and the ideas available. Besides, given your silence on all these issues during the campaign, I'm confident you're ready to unveil a dazzling program.

Sincerely,
A Friend.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

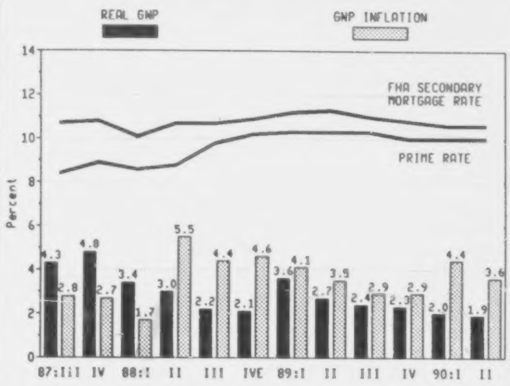
The U.S. Department of Commerce reported that the pace of economic growth, as measured by the inflation-adjusted Gross National Product, slowed during the third quarter to an annual rate of 2.2 percent, the slowest pace since the fourth quarter of 1986. The economy grew at an annual rate of 3.2 percent in the first half of 1988, but its rate of growth has slowed as the year has progressed: the 3.4 percent first quarter growth rate was followed by a 3.0 percent second quarter growth rate. These slower growth reports were accompanied by news that inflation (as measured by the GNP price index) reached an annual rate of 4.9 percent in the third quarter, virtually unchanged from the 5.0 percent of the second quarter. The succession of slower real GNP growth rates so far in 1988 suggests the economy may be losing some of its steam and that the threat of inflation is almost past. Actually, the economy is much healthier than the recent GNP reports suggest, and the potential for rising rates of inflation remains strong.

The slower rate of real GNP growth originated in slower economic activity in virtually all sectors. Specifically, this past summer's severe drought, a slowdown in federal defense purchases, and more modest gains in exports and capital spending combined to produce the decline. However, drought-related losses are hiding what continues to be a surprisingly strong economy entering its seventh year of expansion. The U.S. Department of Commerce has estimated that the total loss to the economy from the drought will be approximately $13 billion in 1982 dollars (inflation-adjusted terms). This past summer, a full $2.3 billion (at a quarterly rate) was subtracted from the second quarter real GNP estimate, and $3.7 billion was subtracted from the third quarter GNP estimate just released. The remaining losses will be used to reduce the fourth quarter real GNP estimate. In sum, the Department of Commerce reduced the third quarter estimate of real GNP growth by about 0.6 percentage points, and government economists plan to reduce the fourth quarter estimate (released in January 1989) by over one full percentage point.

Improvement in the Trade Deficit Pauses...

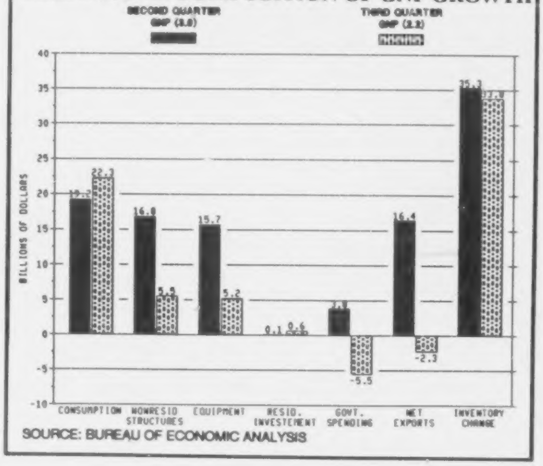
The monthly fluctuations in the trade deficit continue to cloud the issue of whether the U.S. merchandise trade balance is improving. The most recent data shows that the August U.S. trade deficit widened to $10.6 billion from $8 billion in July. The July gap was the smallest in over three years. A better way to evaluate U.S. trade performance is using a three month moving average of the trade deficit, centered on the month indicated in Graph 3. In the top frame, the sharp rise in exports from about September 1987 to April 1988 is clear; as is the much slower growth in imports during the same period. The bottom frame shows the net result over that period: a shrinking trade deficit. In the second quarter of this year, slower growth in Japan and West Germany has reduced the flow of U.S. exports to those countries, and has virtually stalled improvement in the trade deficit. In addition, the earlier growth in U.S. exports has created jobs and boosted incomes of American workers who are still attracted to imported goods.

GRAPH 1: THE ECONOMIC OUTLOOK



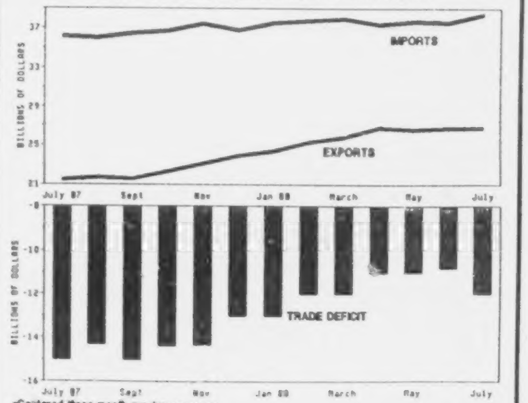
E NAR estimates(1988:III thru 1989:IV)

GRAPH 2: THE COMPOSITION OF GNP GROWTH



SOURCE: BUREAU OF ECONOMIC ANALYSIS

GRAPH 3: THE TRADE DEFICIT



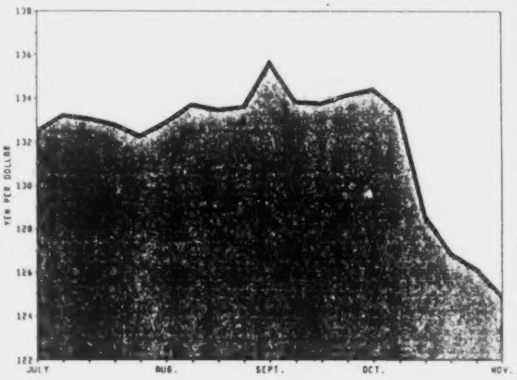
*Centered three month moving averages

SOURCE: DEPT. OF COMMERCE

...And the Dollar Falls Again

The stutter step dance of the monthly trade figures has caused traders in international currency markets to push the dollar sharply lower from its early summer heights. Most of the decline has come recently, as U.S. interest rates have drifted lower. The Fed, apparently confident that the economy is not overheating, has refrained from further reducing the availability of credit, as it did on several occasions earlier this year. Without higher interest rates to attract them, international investors are not as willing to hold dollar-denominated assets. This has helped touch off another sustained drop in the value of the dollar in relation to the Japanese Yen. Consequently, both the Federal Reserve and the Bank of Japan have recently intervened heavily in currency markets, working together to maintain the value of the dollar near a floor of what appears to be about 125 Yen. In the days before the election, currency traders seem to have yielded to the wishes of the two central banks and have not mounted a concerted effort of their own to push the dollar lower.

GRAPH 4: THE DOLLAR FALLS

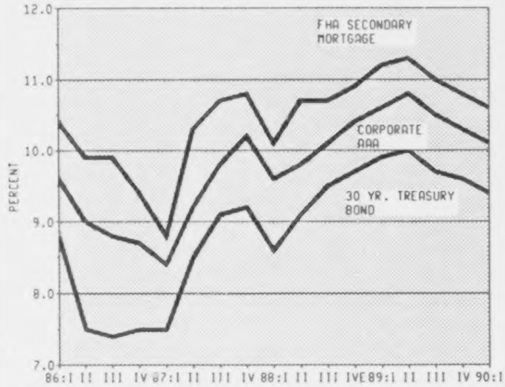


SOURCE: GENERALE DE BANQUE, NEW YORK.

Interest Rates

The path of long-term interest rates, including those on fixed rate mortgages is expected to trend upward slightly through the first half of 1989. The reason for this is closely tied to the assumptions in this forecast relating to the path of real GNP growth. While the third quarter GNP report suggested a pause in the rate of economic growth, it did not provide conclusive evidence of an extended slowdown. More likely, the economy will continue to expand through 1989; but as it does, wage and price pressures will increase. The likely result is a faster rate of inflation due to stronger domestic demand and a gradual decline in the value of the dollar. Therefore, mortgage interest rates are expected to creep above 11 percent before trending back down in mid-1989.

GRAPH 5: LONG-TERM INTEREST RATES



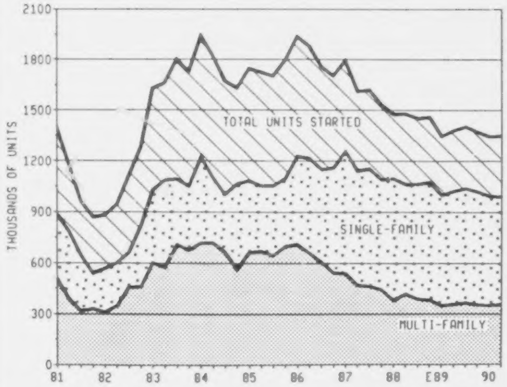
SOURCE: THE FEDERAL RESERVE BOARD

REAL ESTATE MARKETS

Housing Starts

Total starts of privately owned housing units reached a seasonally adjusted annual rate of 1.453 million units in September, 1.5 percent above August's rate of 1.431 million units, and 13.5 percent below the September 1987 annual rate of 1.679 million units. For the past three months, changes in starts activity has been led by large moves in the rate of multi-family (two or more) starts. Starts of multi-family units rose 13.2 percent in September to an annual rate of 403,000 units, after falling 12.9 percent in August, and rising 9.6 percent in July. Meanwhile, the annual rate of starts of single-family units has been more constant. Single-family housing starts fell 2.3 percent in September to a seasonally adjusted annual rate of 1.05 million units. Comparing the first nine months of 1988 to those of 1987, total housing starts were down 10.5 percent to 1.143 million units. Starts of single family units totalled 838,500 units at the end of September, down 7.8 percent from the first nine months of 1987, while multi-family units dropped 17.3 percent to a total of 304,300 units. Housing starts are expected to hold steady through the rest of 1988 before slowing considerably next year, totalling 1.467 million units this year and 1.376 in 1989.

GRAPH 6: HOUSING STARTS



SOURCE: Bureau of Census; E NAR Estimates.

New Home Sales

New single-family homes were sold at a seasonally adjusted annual rate of 659 thousand units in September, falling 8 percent from August's rate of 715 thousand units. This marked the largest monthly drop in new home sales this year. The September slowdown is a reflection of buying decisions made during the summer, when homebuyers stepped up their purchases in the expectations of higher inflation and interest rates. Still, September sales were 2.3 percent above the 644 thousand unit annual pace of a year ago. Regionally, there were large movements in the rate of new home sales. The sales pace fell 27.8 percent in the South to a seasonally adjusted annual rate of 216 thousand units (the South's lowest rate in over a year) and rose 17.3 percent in the West to an annual rate of 258 thousand units. In the Northeast, sales were down 12.7 percent to a seasonally adjusted annual rate of 89 thousand units, while in the Midwest sales remained relatively unchanged, rising slightly by 1.0 percent to an annual rate of 96 thousand units. With respect to a year ago, sales fell 23.3 and 20.3 percent in the Northeast and South, respectively, while rising 24.7 in the Midwest and 42.5 percent in the West.

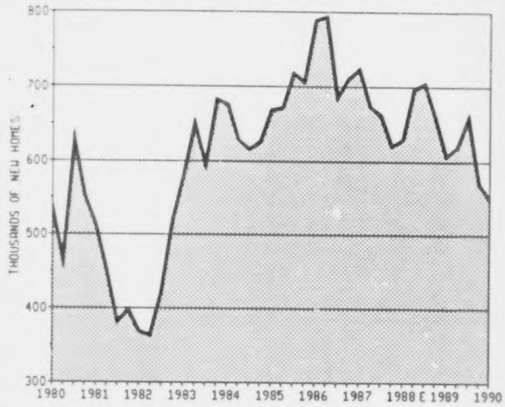
Existing Home Sales

Sales of existing single-family homes fell 2.2 percent in September to a seasonally adjusted annual rate of 3.63 million units. Sales of existing single-family homes have surpassed most expectations this year. For the first three quarters of 1988, existing home sales totaled 2.771 million units, just slightly above the 2.768 million units sold during the first nine months of 1987. Furthermore, September's sales were up 5.8 percent from last September when existing homes were sold at a seasonally adjusted annual rate of 3.43 million units. However, September's decline is further evidence that the surprisingly strong sales pace maintained during most of the year was partly borrowed from the fall and winter. Sales are expected to slow through the remaining months as many purchases that would have been made in the late fall and winter have already been completed during the summer. In addition, modest rises in interest rates are expected to have a sobering effect on the rate of home sales.

Home Prices

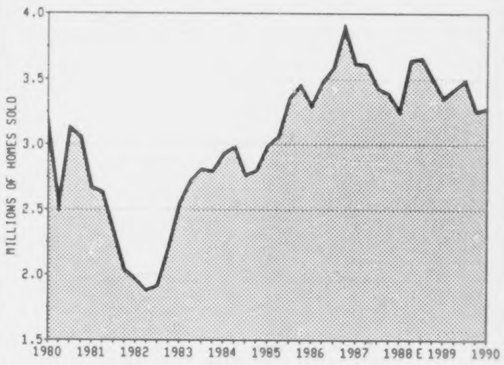
The median sales price of an existing single-family home dropped $2,900 in September to $88,500, 3.2 percent below the August median sales price of $91,400 and 3.5 percent above the $85,500 sales price of September 1987. The median price of existing single-family homes fell back to the level they were at prior to the strong homebuying of the summer: the September price was the lowest seen since April of this year. However, the median sales price of a new single-family home rose 8.1 percent in September to $118,900. September's median new home sales price was 11.2 percent above the median price of a year ago. A slowing in demand coupled with a rise in the new home median price is often the result of potential *new* homebuyers opting for less expensive *existing* homes, thereby skewing the new home sample in favor of high income homebuyers who normally purchase the more expensive new homes.

GRAPH 7: NEW HOME SALES



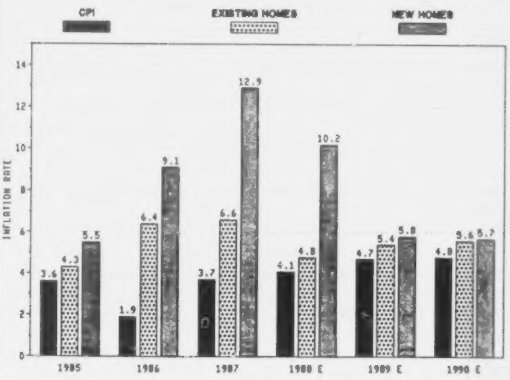
Source: Bureau of Census; E NAR Estimates

GRAPH 8: EXISTING HOME SALES



Source: NAR, E NAR ESTIMATES

GRAPH 9: HOME PRICES



Source:: NAR ECONOMICS AND RESEARCH, E NAR ESTIMATES

REGIONAL DATA

Housing Starts

After falling by 21 percent in the Northeast during August, and 16 percent in the Midwest, housing starts in these regions made moderate gains in September. Starts in the Northeast rose 3.9 percent to an annual rate of 212 thousand units, and rose 6.3 percent in the Midwest to an annual rate of 254 thousand units. However, with respect to a year ago, starts slowed by 16.9 percent in the Northeast and 17.8 percent in the Midwest. In the South, sales fell slightly, dropping 1.9 percent in September to a seasonally adjusted annual rate of 552 thousand units, which is 20.6 percent below the rate of housing starts in September, 1987. The housing market in the West continues to show strength, with housing starts moving up another 2.4 percent to an annual rate of 435 thousand units, 3.6 percent above last September's pace. Comparing the total number of housing units started during the first three quarters of 1988 to those of 1987, housing starts were down in all four regions, falling 10.8 percent in the Northeast to 186.2 thousand units, 10.6 percent in the Midwest to 209.3 thousand units, 11.5 percent in the South to 441.1 thousand units, and 8.9 percent in the West to 306 thousand units.

Existing Home Sales

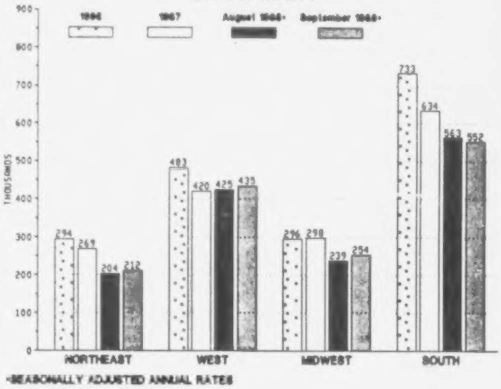
The West continued to provide the source of strength in existing single-family home sales during September. Following a 3.1 percent increase in August, home sales in September moved up 6 percent in the West to a seasonally adjusted annual rate of 710 thousand units, a remarkable 22.4 percent above the September 1987 pace. The strength of the West's housing market has been aided by the fear that local governments in that area are planning to restrict the development of new homes. As for the rest of the nation, sales fell in every region. Existing single-family homes were sold at an annual rate of 650 thousand units in the Northeast, down 5.8 percent from August and 3 percent from September of last year. Sales fell 3.2 percent in the Midwest to an annual rate of 900 thousand units and 2.8 percent in the South to a rate of 1.38 million units, gaining 1.1 and 7 percent, respectively, over the September 1987 rate.

Home Prices

The median price of an existing single-family home fell in every region across the nation during September. The median price in the Midwest fell 4.0 percent to $67,100, its lowest level in 1988 and 1.5 percent above its September 1987 level. Home prices in the Northeast fell by 3.5 percent to $141,400, 6.1 percent above the median price of a year ago. In the West, the median price dropped 2.0 percent to $124,300 (7.1 percent above last September's price), and in the South existing home prices fell 1.2 percent to $82,400 (3.6 percent higher than a year ago).

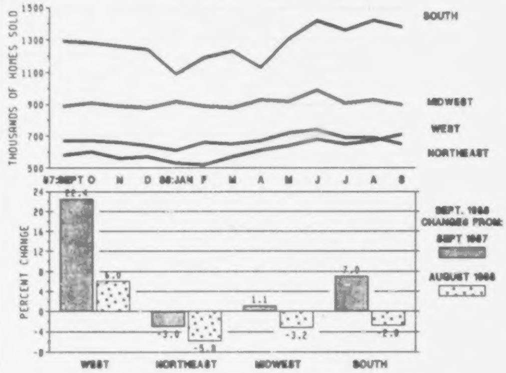
Sean A. Burns
Director of Forecasting
Beth M. Maerz
Research Associate
Forecasting & Policy Analysis Division

GRAPH 10: HOUSING STARTS BY REGION



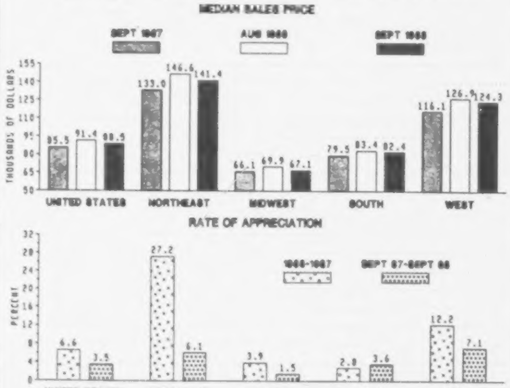
*SEASONALLY ADJUSTED ANNUAL RATES
Source: BUREAU OF CENSUS

GRAPH 11: EXISTING SINGLE-FAMILY HOME SALES BY REGION



Source: NAR Economics and Research.

GRAPH 12: HOME PRICES BY REGION



Source: NAR Economics and Research

SPECIAL SUPPLEMENT: THE FSLIC CRISIS

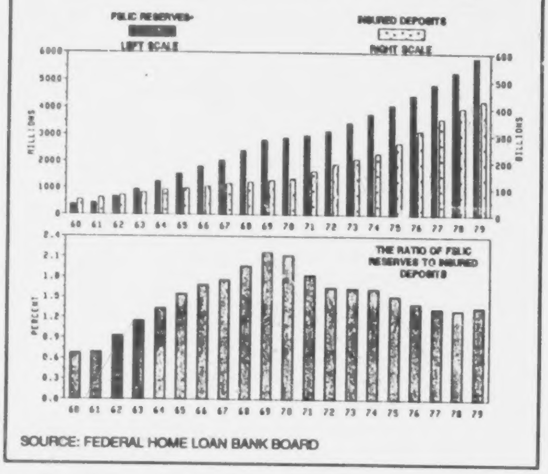
Stories of the rising number of failed thrifts and their often ill-advised investment strategies have focused public awareness on the issue, bringing with it questions concerning the cost of bailing the S&L's out, and highlighting the Federal Savings and Loan Insurance Corporation's (FSLIC) inability to do so. In this special supplement, we offer a concise description of how the crisis developed, and how much experts have estimated it will cost to resolve it.

While some commentators claim that mismanagement and irresponsibility by the FSLIC are the cause, a more careful analysis reveals that the reasons go much deeper, rooted in the rapidly changing environment in which the savings and loan industry has operated for more than a decade. From 1934 to the 1970s, the overall stability of the thrift industry was ensured by a strong demand for mortgages, strict regulations on banking activities, and moderate inflation which, for the most part, led to relatively stable interest rates and good portfolio management. Meanwhile, the FSLIC built up healthy reserves as the value and number of the deposits it insured increased (see graph 1). For four decades the FSLIC lived up to its expectations; bank runs became a villain of the past, the thrift industry ran smoothly with few surprises, and insolvent thrifts were closed quickly and quietly.

The inflation of the 1970s drove interest rates above the interest rate ceilings on thrift's deposits, forcing thrifts into a liquidity crunch, as depositors moved their money into higher yielding money market mutual funds (a market share which the thrifts would never regain). In response, Congress raised the interest rate ceilings in 1980. However, most thrifts held only long-term, fixed rate mortgages, and many S&L's were forced to pay a higher rate on deposits than they were earning on their mortgage portfolios (see graph 2): a recipe for financial disaster. In 1982, the thrift industry was further deregulated, allowing thrifts greater freedom in the type of loans they could offer, and the gap between their cost and return on funds narrowed and eventually reversed; the growing financial crises in the savings and loan industry did not. As many thrifts scrambled to diversify their portfolios out of home mortgages and into every thing from office buildings to fast-food restaurants, they traveled into unfamiliar and risky territory. Futhermore, many claim that the backwards direction in which the thrifts were deregulated (their liabilities before their assets) did irreperable damage. Finally, the fall in oil prices devastated the thrifts holding large portions of their portfolio in the South West. Lacking both the money and the staff, the FSLIC was incapable of supervising, let alone liquidating or merging, all of the struggling thrifts, leaving many insolvent ones in operation.

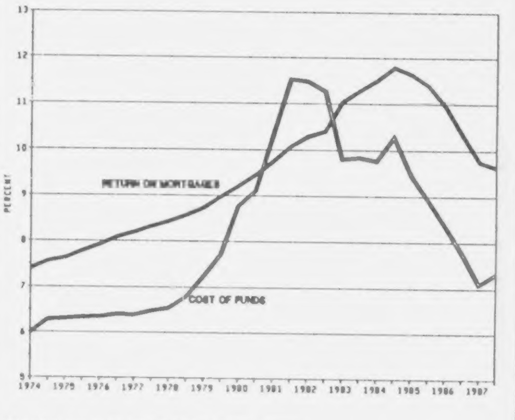
Graph 3 indicates that while thrift closures have increased by 55 percent from 1982, the number of insolvent thrifts has risen by 333 percent. Today, the FSLIC faces over 300 insolvent thrifts who are threatening the entire industry by bidding up the interest rates on deposits in their desperate attempt to attract funds. The real danger is that these institutions have nothing left to lose and they are making increasingly riskier loans on the odds that if the loan turns a profit they win, and if it doesn't the FSLIC loses.

GRAPH 1: THE HISTORY OF THE FSLIC



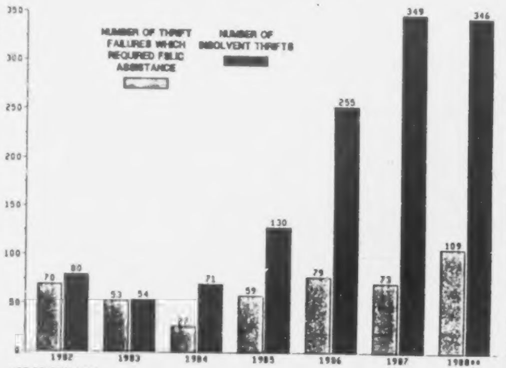
SOURCE: FEDERAL HOME LOAN BANK BOARD

GRAPH 2: THRIFT'S COST OF FUNDS RISE



SOURCE: FEDERAL HOME LOAN BANK BOARD

GRAPH 3: THE NUMBER OF INSOLVENT THRIFTS IS RISING



**AS OF JULY, 1988
*INCLUDES LIQUIDATIONS, MERGERS AND MANAGEMENT CONSIGNMENT CASES

SOURCE: FEDERAL HOME LOAN BANK BOARD

Most analysts agree that insolvent thrifts should be closed as quickly as possible to avoid further losses, and there is a general consensus that the savings and loans need to be more closely regulated to ensure that a crisis of this magnitude never happens again. But that's about as far as the agreements go. Cost estimates for closing the more than 300 insolvent thrifts range from $40 billion to over a $100 billion, and when the discussion turns to who will actually pay for the closures, the chances for an expedient, as well as effective, solution look very slim.

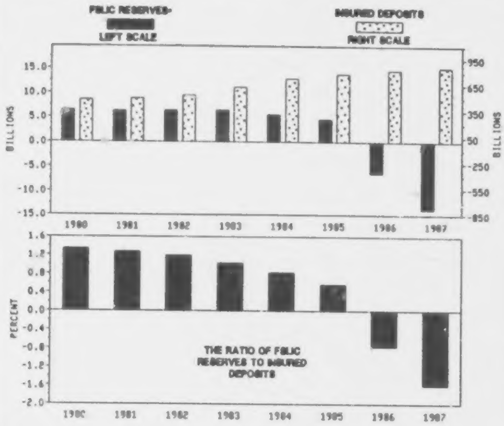
Many argue that the thrifts caused the problem and they should be the ones to clean it up. However, this is not a practical solution, as the thrift industry lacks the means to heal itself. To demonstrate, Graph 4 illustrates the deterioration of the FSLIC fund over the past seven years, which ended 1987 $13.7 billion in debt. If the thrift industry is made to pay, the cash would have to come from the thrifts in the form of an additional insurance premium or special assessment. But, the thrift industry is broke, having grossed a negative $3.6 billion in the second quarter of 1988. In addition, thrifts already pay twice the insurance premium charged to banks insured by the FDIC, and the U.S. League of Savings Institutions estimates that last year the special assessments forced approximately one hundred profitable thrifts into insolvency, meaning that additional charges will only aggravate the problem. Finally, rising special assessments would likely encourage the more healthy, well capitalized thrifts to search for loopholes in the moratorium on converting to FDIC insurance, and make the switch.

Another solution offered, is to merge the FSLIC and the FDIC, pushing some of the cost burden onto FDIC-insured banks. The banks, arguing against this, have asserted that it is unfair to expect them to pay for the mistakes of the thrift industry while they themselves were playing by different, and often stricter, rules and standards. Futhermore, banks have also suffered in recent years, and the FDIC's reserves (which were used to close some 200 banks this year) are not as strong as they have been or should be (see graph 5), leading many to fear that a merger between the FDIC and the FSLIC could jeopardize the entire banking system.

The list of possible solutions includes a taxpayer bailout. So far, however, congress has been unwilling to commit the tax payer to a FSLIC bailout, whose deficit at the end of 1988 is estimated in the range of $20 to $50 billion. The growing concern is that the longer insolvent banks are allowed to stay in operation, the larger the crisis will grow. Over the past five years, FSLIC aided bailouts have become more expensive. In 1982, the FSLIC paid out 6 cents for every dollar of assets held by the thrifts it closed down. Today this ratio has risen to almost 50 cents per dollar asset. The longer a solution is discussed and not implemented, the more costly it will become.

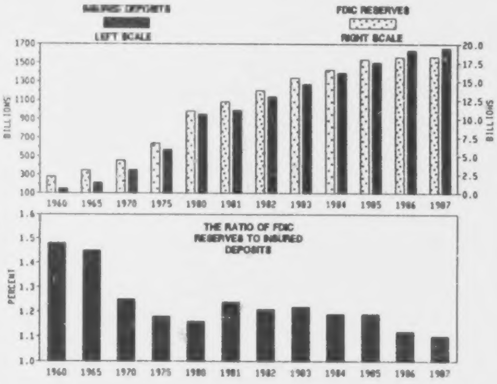
Beth Maerz
Research Associate
Forecasting & Policy Analysis Division

GRAPH 4: FSLIC RESERVES ARE IN THE RED



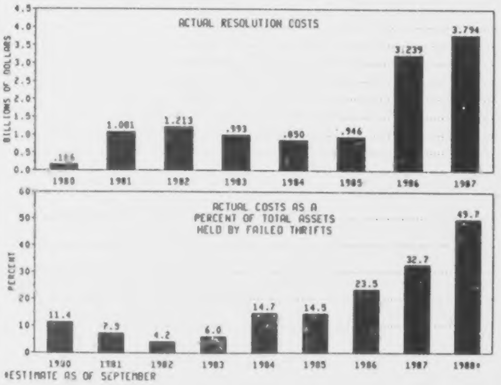
SOURCE: FEDERAL HOME OAN BANK BOARD

GRAPH 5: THE RESERVES OF THE FDIC



SOURCE: THE FEDERAL DEPOSIT INSURANCE CORPORATION

GRAPH 6: THE GROWING COST OF THRIFT FAILURES



SOURCE: FEDERAL HOME LOAN BANK BOARD

SECONDARY MARKET OUTLOOK

by
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This year has been one of consolidation for the mortgage lending industry. Originations of new mortgage loans are off by an estimated 30% over last year. The initial reaction of lenders has been to reduce staff and close offices. The follow-up strategy, now well underway, appears to be expansion of product sources through wholesale mortgage production.

Wholesale mortgage lending is the purchase of mortgages, including servicing, for resale in the secondary market. Wholesalers establish correspondent networks with mortgage bankers, brokers and even institutional lenders by offering programs in which loans are originated and sold in pools as small as individual loans. The wholesaler aggregates loans and packages them for sale directly to investors, including Fannie Mae and Freddie Mac, as well as Ginnie Mae pools. Like a traditional mortgage banker, the wholesaler retains the servicing on the loans it sells.

Wholesale mortgage banking became popular with large institutional lenders in the early eighties. Traditional retail lending, in which the lender uses its own loan originators to produce loans for portfolio or sale, requires investment in recruiting, training and management. When interest rates began declining several years ago, retail lenders experienced high staff turnover, as new market entrants stole high volume loan producers to buy their way into the rapidly expanding mortgage origination market.

Retail mortgage lending also requires the lender to develop a customer base with borrowers (or REALTORS®), directly in competition with other retail lenders.

Wholesale mortgage banking offers the ability to expand the lender's mortgage acquisitions by "contracting out" originations to independent loan producers. These correspondents develop their own customer base to whom they market the wholesaler's product lines. Loans are delivered to the wholesaler for approval and funding.

Wholesale programs offer a variety of options to correspondents. Typically, wholesalers buy FHA and VA loans on a short term commitment basis; that is, the loans have already been closed when the commitment is issued, and delivery is immediate, often within a week. Servicing is usually priced separately, and prices may be negotiated with the wholesaler.

Conventional loan programs generally offer longer term commitments, and a variety of options under which loans may be delivered. Wholesalers may pre-approve a loan application, and offer a "registry" system under which a pre-approved loan must be delivered if it is closed. This is an attractive option for the originator, who is guaranteed a price/rate but is not required to deliver if the loan does not close.

The advantages of wholesale mortgage lending for originators are several: they have access to a wide variety of programs (many deal with several wholesale firms), they have "flow-funding" --funding for individual sales of loans--for servicing released sales, and with some wholesalers, they can close loans in the wholesaler's name, rather than drawing down on their own lines of credit. Even large volume originators and portfolio lenders use wholesale mortgage programs to dispose of mortgages they may originate in small volume, or loans with coupons too small to pool into securities that will bring an adequate price in the secondary market.

Wholesalers, by virtue of the volume of product they purchase, can aggregate large volumes of loans which are generally more profitable to sell. They can also reach into distant markets efficiently, and with overnight delivery service, offer underwriting and processing services with turnaround times competitive with local lenders.

Wholesalers have some specialized problems, however. Correspondents are not employees, and are notoriously price-sensitive and fickle. There is little loyalty to a particular wholesaler, and a customer base can erode very quickly as a competitor wholesaler offers better pricing or more attractive underwriting. Competitive pressures have prevented some wholesalers from being able to charge fees for commitments, and enforcing delivery requirements may be difficult because there is often limited means to determine whether a registered loan was in fact closed.

Thus, purchase activity--the volume of mortgages a wholesaler buys--can vary substantially and may be difficult to control or maintain. This makes risk management and control of the production pipeline more difficult for wholesalers than for traditional retail lenders.

For these reasons, many wholesalers believe that a strong retail lending business is necessary to support wholesale activity and maintain a minimum level of production.

The effect for homebuyers and REALTORS® of increased wholesale mortgage banking should be positive. Wholesale outlets offer even small originators the ability to compete by providing access to the secondary market and the opportunity to sell mortgage servicing. Because they act as aggregators, wholesalers often can provide outlets for a broad range of mortgage types and for specialized mortgage products that may not be sellable in small volume or to traditional mortgage investors.

Wholesale mortgage programs offer an important outlet for boutique mortgage lenders, who can respond to market demands for specialized products using wholesale outlets. As the traditional secondary market has focused increasingly on standardized mortgage types, this alternative has become increasingly important, particularly in areas of the country where market conditions and sophisticated consumers have created greater need for mortgages beyond plain vanilla.

Competition among wholesalers for correspondents has intensified. For homebuyers, this should mean greater choice, more attractive pricing and better service in financing their homes.

EXPLAINING TRENDS IN HOMEOWNERSHIP

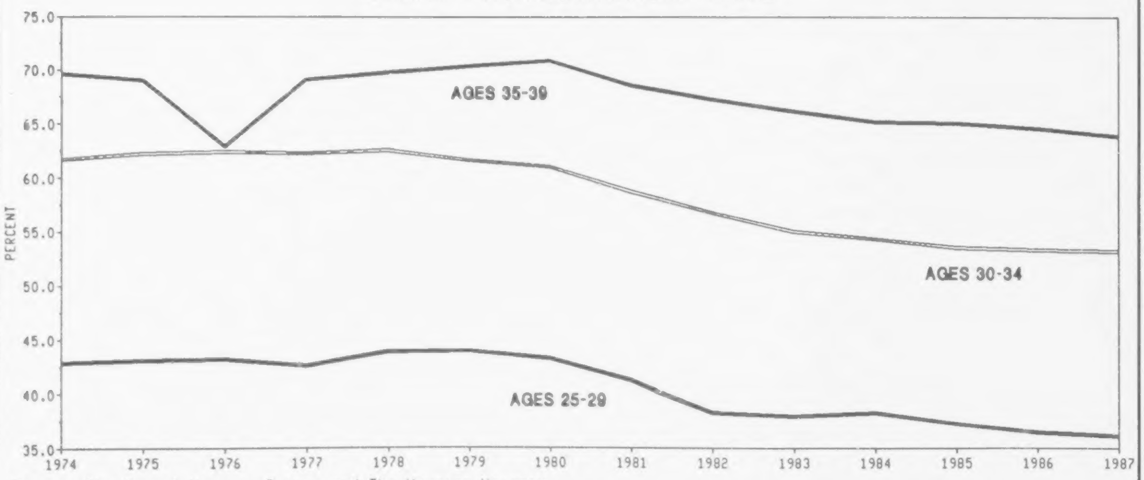
Since the end of World War II, the U.S. has become increasingly a nation of homeowners. From 1950 to its peak in 1980, the homeownership rate grew from 55 to over 65 percent. Since 1980, however, the homeownership rate has been declining. Although the rate is still above the post-war low and is in line with the rates experienced during the late 1960s, the homeownership rate at the end of the current decade will probably be lower than the rate in 1980.

The 1.6 percentage point decline in the aggregate homeownership rate from 65.6 percent in 1980 to 64.0 percent in 1987 masks the acute declines experienced by some subgroups. See Chart 1. For example, the percentage of households in their prime buying years of 25 to 29 years who owned homes declined 7.4 percentage points between 1980 and 1987, from 43.3 percent to 35.9 percent. For households between 30 and 34 years, the decline was 7.9 percentage points, from 61.1 percent to 53.2 percent. The homeownership rate of households age 35 to 39 has generally been, and continues to be, slightly higher than the aggregate homeownership rate.

The aggregate homeownership rate is affected by a variety of phenomena including the population's demographics, social norms, prevailing economic conditions and households' preferences for homeownership. Specifically, in the absence of any offsetting changes, each of these factors (although the list is not exhaustive) is associated with affecting the demand for homeownership.

- *Income* – Rising household incomes increase the rate of homeownership.
- *House Prices* – Rising home prices impede the ability of many prospective buyers to attain homeownership. At the same time, the prospect of future increases in home prices attracts buyers.
- *Homeownership Costs* – Changes in the ongoing costs associated with homeownership also impact homeownership. These costs include the after-tax cash cost, which is mortgage interest, property taxes, insurance, fuel and utilities and maintenance, reduced by the tax savings associated with homeownership. Total costs also include some items not actually "paid" each year in the literal sense. That is, total costs are the after-tax cash cost plus opportunity cost of downpayment and amortization of fees and closing costs, less expected equity buildup.
- *Age Profile of the Population* – Since older households typically have higher rates of homeownership, the greater the proportion of households in older age groups, the higher the aggregate homeownership rate.
- *Shifts in Household Composition in the Population* – Since married households typically have higher homeownership rates, the greater the proportion of "marrieds" in the population, the higher the aggregate homeownership rate.

CHART 1: HOMEOWNERSHIP RATE



Source: The Annual Housing Survey and The Housing Vacancy Survey, Bureau of the Census.

TABLE 1
HOME OWNERSHIP, INCOME AND AFFORDABILITY (ALL HOUSEHOLDS)

	Home Ownership Rate	Median Household Income (86$)	% Change	Existing Home Price (86$)	% Change	Composite Affordability Index	Median 1st-Time Buyers Afford. Index
1974	64.6	28,687		66,744		130.3	-
1975	64.7	27,949	(2.6)	68,155	2.1	123.5	-
1976	64.8	28,811	3.1	69,566	2.1	125.8	-
1977	64.8	28,966	0.5	73,515	5.7	120.6	-
1978	65.2	29,647	2.4	77,743	5.8	111.4	-
1979	65.5	29,588	(0.2)	81,414	4.7	97.2	-
1980	65.6	27,974	(5.5)	82,095	0.8	79.9	-
1981	65.3	26,991	(3.5)	80,227	(2.3)	68.9	-
1982	64.7	26,618	(1.4)	77,188	(3.4)	69.5	50.6
1983	64.9	27,155	2.0	77,495	(0.4)	83.2	59.4
1984	64.4	27,903	2.8	76,552	(0.8)	89.1	64.9
1985	63.9	28,269	1.3	77,120	0.7	94.8	68.3
1986	63.8	29,458	4.2	80,300	4.1	108.9	75.6
1987	64.0	N/A	N/A	82,358	2.6	113.8	80.6

Sources: Homeownership rates from the *Annual Housing Survey* and the *Housing Vacancy Survey*, Bureau of the Census. Household income from *Current Population Reports*, Series P-60, No. 154, Bureau of the Census. Home prices and affordability

Each of the above factors, and how they have changed from the mid-1970s through the present, explain some of the homeownership rate's steady increase through 1980, and subsequent fall thereafter. Below we examine more closely the determinants of homeownership and what housing analysts have found as to their relative importance.

Income, House Prices and Affordability

Not surprisingly, household income has been found to have a positive impact on the probability of a household's choosing homeownership. Moreover, the preponderance of evidence suggests that rising real incomes *over time* during the mid- and late 1970s were at least partially responsible for the rising homeownership rate in the latter 1970s. In the same vein, the negative growth in real household income during the opening years of the 1980s (see Table 1) is partially responsible for the decline in the homeownership rate.

Rising incomes are only part of the affordability puzzle, though. Are incomes rising fast enough to compensate for simultaneously rising home prices? Each month NAR puts out two estimates of housing "affordability": an index for all homebuyers and an index designed to represent first-time homebuyers. Both measure the relationship between median household income and the income needed to qualify for a mortgage loan on a median price home.[1]

Table 1 shows the trend over the 1970s and the 1980s in real house prices as well as the Housing Affordability and First-Time Buyer indexes. Affordability, as measured by the composite housing affordability index, declined steadily during the 1970s and the beginning years of the 1980s, but began to rebound after 1982. In fact, 1986 represented the first time since 1978 that the index was above 100. While the composite index augured well for prospective homebuyers, the first-time buyer affordability index effectively points out the plight of first-time homebuyers. Although rising since 1982, first-time homebuyers' 1987 incomes remain nearly 20 percent below that needed to qualify for a mortgage loan on a starter home.

Cost of Homeownership

The affordability indexes capture the ability of a typical household to qualify for a typical home. Another angle on affordability is the ongoing cost of homeownership. A true estimate of the cost of homeownership incorporates not only the observable cash outlays but also the indirect costs and tax benefits of homeownership. The "after-tax cash cost" of homeownership is the sum of several on-going cash outlays (including mortgage interest payments, fuel and utility costs, maintenance and repairs, real estate taxes and insurance) less the income-tax savings of homeownership. The income-tax benefits include a household's ability to deduct mortgage interest and real property taxes in calculating taxable income and its ability to defer capital gains taxes upon home sale.

A broader measure, "total homeownership cost", includes the after-tax cash cost of homeownership as well as two indirect costs of homeownership. First, since the funds used for a downpayment could have been invested in another income-producing asset, there is a cost associated with the foregone earnings. Second, there are

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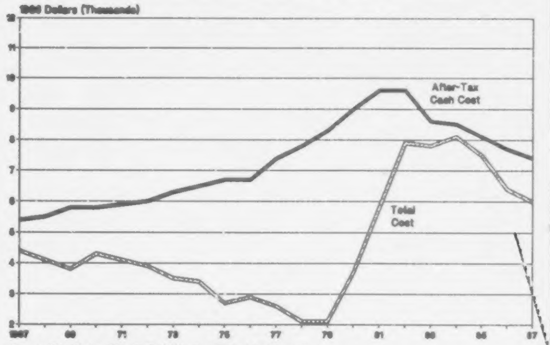
[1] The first measure, Housing Affordability, bases the monthly principal and interest amount on a 20 percent downpayment and the median price for all existing single family homes. Moreover, the median income is for all homebuyers, both first-time and repeat. Whereas, the other index, First-Time Homebuyer Affordability, bases its mortgage loan amount on a 10 percent downpayment and the median price of a starter home. The income used in its calculation is only that of first-time homebuyers (the first year of its calculation is 1982). A value of 100 for both the Housing Affordability and the First-Time Homebuyers Affordability indexes suggests that family income is sufficient to qualify for the mortgage loan. NAR's monthly report Home Sales:

CHART 2: HOMEOWNER COSTS (in 1986 Dollars)



Source: The State of the Nation's Housing 1988, Joint Center for Housing Studies of Harvard University, P.2 and Appendix Table 1.

the up-front fees and closing costs which accrue to the home acquisition and must be amortized (usually over the expected life of the loan, about 7 or 8 years). To reflect the true cost, this must be subsequently reduced by the expected annual equity buildup from house price appreciation. The rationale for this is that the increase in the *investment* value of the housing asset accruing to inflation reduces the cost of the asset.

Chart 2 illustrates the trends in both the after-tax cash cost and total cost of homeownership. The chart shows that both the after-tax cash cost and the total cost of homeownership, which have been declining slightly over the last five years, are still well above their levels in the 1960s and the early 1970s. During the period of rising real home prices in the 1970s (see Table 1), the total cost of homeownership was declining. So despite rising after-tax cash costs, declining total cost kept the investment-motivated demand for homeownership strong through 1979. The subsequent slowdown in the rate of home price appreciation (nationally) has kept total cost only slightly below after-tax cash cost in recent years.

In addition to absolute increases, homeowner costs are now higher in relation to rental costs than they were in the 1970s. The rapid run-up in mortgage rates in the early 1980s abruptly raised total homeowner costs relative to the more gradually rising rental costs. While the situation has improved for homeowner costs somewhat in recent years, these trends strongly suggest that higher homeownership costs (relative to rental costs) have contributed to the fall in the homeownership rate experienced in the 1980s. Indeed, one study suggests that nearly one-half of the rise in the homeownership rates of married couples under 45 between 1973 and 1979 and over one-half of the fall between 1979 and 1983 can be explained by the respective falling and rising of homeownership costs.[2]

One important component of homeownership costs is financing. While market mortgage interest rates have fallen continually since the early 1980s, the real costs of borrowing (market rates less the expected rate of inflation) have remained high by historical standards because inflation has fallen also. Thus, while the recent drop in the market rates has spurred some recent activity in home sales, etc., the cost of borrowing is still an obstacle to many prospective homeowners.

The "burden" of housing costs to first-time homebuyers, which is the cost of a representative housing unit as a percent of household income, remains historically high. This is true for both after-tax cash and total costs of homeownership to first-time homebuyers. Table 2 indicates that the cash burden, although currently lower than its 45 percent high in 1982, remains at almost one-third of household income in 1987. This is substantially higher than the cash burdens to first-time homebuyers of the early 1970s, which were closer to one-quarter of household income. Similarly, the total cost burden to first-time homebuyers, which was as low as nine percent in 1978, is currently over one-quarter of household income partially as a result of cooling house price appreciation since 1981.

Demographics

The distribution of total households in various age groups, income classes, household types, etc. impacts the homeownership rate. This is because certain subgroups of the population have historically demonstrated higher propensities to own their homes than others. Married couples, both with and without children, have historically had higher homeownership rates than other household

TABLE 2
FIRST-TIME HOMEBUYER COST BURDEN*: 1970 - 1987

Year	Cash Burden**	Total Burden***
1970	23.1%	17.0%
1975	27.8	11.4
1978	33.4	8.7
1979	37.0	9.5
1980	41.1	16.8
1981	44.5	27.1
1982	45.4	37.4
1983	40.0	36.7
1984	38.5	36.7
1985	36.3	33.7
1986	33.9	28.3
1987	32.4	26.2

*First-time Buyer Cost Burden is cost as a percent of income of potential homebuyer proxied by median family income of married couple renters aged 25 to 29.

**Cash burden is the after-tax cash cost of homeownership as a percent of income of "potential" homebuyers.

***Total burden is the total cost of homeownership as a percent of income of "potential" homebuyers.

Source: The State of the Nation's Housing 1988, Joint Center for Housing Studies of Harvard University, Appendix Table 1.

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[2] Donald R. Haurin, Patric H. Hendershott and David C. Ling, "Home Ownership Rates of Married Couples: An Econometric Investigation", Housing Finance Review, Summer 1988.

types. Similarly, older households typically have higher homeownership rates than younger households. Because of the differentials in homeownership rates between various subgroups, the aggregate homeownership rate can change as the population "ages", becomes "more married", etc. For example, between 1970 and 1985, the percentage of young singles has been steadily rising. In 1970, only 20 percent of all males between the ages of 25 and 29 were single; by 1980, just under one-third were single; and by 1986, over forty percent of all males age 25 to 29 were single. This rise is even more pronounced for young (age 25-29) females, only 11 percent of whom were single in 1970, but 28 percent of whom were single in 1986.

Table 3 presents the distribution of households over four household types--married, other family, single and other non-family. While there are still many more married households, the percent changes from 1970 to 1980 and from 1980 to 1987 for other family, single and other non-family households far surpass the growth in married households over the same periods. This demographic shift, from subgroups with high propensities to own their homes to those with historically lower propensities to own, explains some of the recent decline in the homeownership rate.

Conclusion and Future Prospects for Homeownership

The decline in the homeownership rate since 1980 has been associated with several trends in homeownership's causative factors. Worsening affordability, i.e., the ability of the typical household to purchase the typical house, has occurred with the confluence of lagging real incomes and rising real house prices. Also, the cost of homeownership has risen due to rising after-tax cash costs and reduced house price appreciation. Demographic shifts, such as the delaying of marriage and the general shift toward single households, have reduced the rate at which people become homeowning households. These trends have hit younger households, i.e., prospective first-time homebuyers, especially hard, explaining the acute drop in homeownership for them.

What does the future hold regarding homeownership? Because forecasting the trends in interest rates or inflation is such a tricky business, it is problematic to forecast trends in homeownership costs and house prices. And given the recent propensity to alter the tax code, we would hesitate to state that the current tax laws will persist. But if the tax law did remain, homeownership should not be greatly affected from that source; the adverse impact of the reduced value in homeowner tax deductions (from lower marginal tax rates) should be offset at least somewhat because rental housing took a much larger hit — thus, rents should rise and owner-occupied housing will still look relatively attractive.

One area, though, where we can hazard a guess is regarding demographic trends. One relatively large effect on the homeownership rate stems from the rate of household formations. A recent study by the Joint Center for Housing Studies of Harvard University, *State of the Nation's Housing – 1988*, projects that in the years ahead, the aging of the baby boom generation and the emergence of the baby bust generation into their prime household formation years will cause a deceleration in annual household growth, which could adversely affect homeownership demand. Actual household growth averaged 1.51 million households a year from 1975 through 1980, and 1.31 million in the first half of the 1980s. Annual household growth is expected to average 1.45 million a year from 1985 to 1990, falling to 1.21 million a year in the early 1990s and 1.08 million a year in the late 1990s.

The State of the Nation's Housing – 1988 projects that despite decreasing household formations accompanying the aging of the baby-boomers, many baby-boomers are just now marrying and having children. Since marrieds with children tend to have a high propensity to own their homes, those who do not own will likely buy during the late 1980s and early 1990s, increasing the demand for homeownership somewhat. While over one-half of the baby-boomers already own homes, this aging of the baby-boomers and passage through their peak earning years in the late 1980s and early 1990s will make for a strong trade-up demand. Nonetheless, it is important to stress that a persistence of historically high homeowner costs and house prices will continue to make it difficult for households to make the transition to homeownership.

by
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TABLE 3
HOUSEHOLDS, BY TYPE:1960-1987
(in thousands)

	Married Couple	Other Family	Single	Other Non-Family
1960	39,254	5,651	6,896	999
1970	44,728	6,728	10,851	1,094
1975	46,951	8,612	13,939	1,618
1980	49,112	10,438	18,296	2,930
1983	49,908	11,485	19,250	3,275
1984	50,090	11,907	19,954	3,456
1985	50,350	12,356	20,602	3,480
1986	50,933	12,625	21,178	3,722
1987	51,537	12,954	21,128	3,860
Percent Change				
1970-1980	9.8	55.1	68.6	167.8
Percent Change				
1980-1987	4.9	24.1	15.5	31.7

Source:Current Population Reports, Series, p-20, No.417, Bureau of the Census.

U.S. ECONOMIC OUTLOOK NOVEMBER 1988

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	88.2	88.3	88.4	89.1	89.2	89.3	89.4	90.1	1986	1987	1988	1989	1990
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4824	4900	4982	5077	5154	5222	5290	5375	4240	4527	4857	5186	5494
% Change	8.7	6.4	6.9	7.9	6.2	5.4	5.3	6.5	5.6	6.8	7.3	6.8	5.9
% Change (w/out inflation)	3.0	2.2	2.1	3.6	2.7	2.4	2.3	2.0	2.8	3.4	3.8	2.7	2.3
Consumer Price Inflation (CPI)	4.8	4.7	4.4	4.9	4.8	4.6	4.6	5.5	1.9	3.7	4.1	4.7	4.8
GNP Inflation (GNP Deflator)	5.5	4.4	4.6	4.1	3.5	2.9	2.9	4.4	2.7	3.3	3.3	4.0	3.6
Unemployment Rate - Civilian	5.4	5.5	5.4	5.4	5.5	5.5	5.5	5.5	7.0	6.2	5.5	5.5	5.6
Civilian Employment-Household Basis (millions)	114.6	115.2	115.8	116.0	116.5	117.0	117.5	117.9	109.6	112.4	115.0	116.7	118.5
Percent change	1.5	1.9	2.0	0.9	1.7	1.7	1.7	1.4	2.3	2.6	2.2	1.6	1.5
Index of Industrial Production	136.0	138.2	139.4	139.4	140.2	141.1	141.9	142.2	125.1	129.8	137.0	140.7	143.4
Manufacturing Capacity Utilization	83.2	83.8	83.9	83.8	83.8	83.9	83.8	83.7	79.7	81.0	83.4	83.8	83.8
Domestic Auto Sales	7.5	7.6	7.2	7.2	7.2	7.2	7.2	7.0	8.2	7.1	7.5	7.2	7.0
Federal Tax Receipts (NIPA) as % of GNP	20.4	19.8	19.9	20.0	20.1	20.1	20.1	20.6	19.5	20.2	20.1	20.1	20.6
Federal Expenditures (NIPA) as % of GNP	23.1	22.4	22.7	23.0	22.9	22.8	22.8	22.9	24.4	23.7	22.9	22.9	22.9
Deficit(NIPA)	-133.3	-127.1	-141.1	-148.7	-144.8	-142.3	-143.8	-121.8	-205.6	-157.8	-139.1	-144.9	-124.4
as % of GNP	-2.8	-2.6	-2.8	-2.9	-2.8	-2.7	-2.7	-2.3	-4.9	-3.5	-2.9	-2.8	-2.3
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4674	4689	4550	4322	4415	4493	4238	4241	4712	4648	4557	4367	4232
Percent change – year ago	-0.5	3.5	2.3	-2.0	-5.5	-4.2	-6.9	-1.9	10.8	-1.4	-2.0	-4.2	-3.1
Existing Single-family Home Sales (thousands)	3643	3657	3507	3353	3422	3486	3250	3276	3565	3526	3514	3378	3255
Percent change – year ago	0.9	6.6	3.5	3.2	-6.1	-4.7	-7.3	-2.3	10.9	-1.1	-0.3	-3.9	-3.6
Housing Starts (thousands)	1481	1454	1458	1347	1382	1403	1371	1346	1812	1634	1467	1376	1365
Percent change – year ago	-7.8	-10.2	-4.9	-8.8	-6.7	-3.5	-6.0	-0.1	4.1	-9.8	-10.2	-6.3	-0.7
Single-Family Units	1063	1064	1076	999	1024	1038	1019	995	1183	1157	1075	1020	1007
Percent change – year ago	-6.5	-7.8	-1.3	-8.9	-3.7	-2.5	-5.3	-0.4	10.4	-2.2	-7.1	-5.1	-1.2
Multi-Family Units	418	389	383	348	358	365	352	351	630	477	392	356	358
2-4 Family Units	57	58	57	52	54	55	53	53	85	66	57	53	54
Percent change – year ago	-20.4	5.4	1.8	-7.4	-6.5	-6.4	-8.0	0.8	-9.0	-22.6	-12.8	-7.1	0.7
5 + Family Units	360	331	325	296	304	310	300	298	545	412	335	302	305
Percent change – year ago	-9.1	-19.1	-15.8	-8.5	-15.6	-6.4	-8.0	0.8	-5.6	-24.4	-18.6	-9.7	0.7
New Single-family Home Sales (thousands)	697	705	660	607	620	660	570	550	750	671	673	614	563
Percent change – year ago	3.4	4.4	6.3	-3.7	-11.0	-6.4	-13.6	-9.4	9.0	-10.5	0.3	-8.7	-8.3
Mobile Homes Shipped (thousands)	219.7	216.3	226.4	217.0	221.6	227.2	231.1	228.9	245.5	232.8	217.3	224.2	233.4
HOME PRICES													
Existing Home Prices - Median $(1000)	88.9	90.2	91.9	92.6	94.3	95.1	96.0	97.1	80.3	85.6	89.7	94.5	99.8
Percent change – year ago	4.5	5.5	8.1	5.5	6.1	5.4	4.5	4.9	6.4	6.6	4.8	5.4	5.6
New Home Prices - Median $(1000)	112.9	115.5	117.0	117.4	121.3	122.5	123.7	124.9	92.0	104.0	114.6	121.2	128.1
Percent change – year ago	9.1	8.8	4.7	4.0	7.4	6.1	5.7	6.4	9.1	12.9	10.2	5.8	5.7
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.7	10.7	10.9	11.2	11.3	11.0	10.8	10.6	9.9	10.2	10.6	11.1	10.7
1-year ARM (without buydown)	7.6	7.6	7.8	8.1	8.2	8.2	8.3	8.1	7.9	8.2	7.6	8.2	7.8
Corporate AAA Bond Rate	9.8	10.1	10.4	10.6	10.8	10.5	10.3	10.1	9.0	9.4	10.0	10.6	10.2
Government Bond Rate	9.1	9.5	9.7	9.9	10.0	9.7	9.6	9.4	7.8	8.6	9.2	9.8	9.4
Short-Term Interest Rates													
Federal Funds Rate	7.1	8.1	8.3	8.5	8.7	8.6	8.3	8.3	6.8	6.7	7.6	8.5	8.0
3-month T-Bill Rate	6.2	7.2	7.4	7.6	7.7	7.6	7.4	7.4	6.0	5.8	6.6	7.6	7.1
Prime Rate	8.8	9.8	10.2	10.3	10.3	10.3	10.0	10.0	8.3	8.2	9.4	10.2	9.7
Discount Rate	6.0	6.4	6.7	6.9	6.9	6.9	6.8	6.6	6.3	5.7	6.3	6.5	6.7
Value of the U.S. Dollar (Trade-Weighted Avg.)	90.4	97.6	93.4	90.5	89.5	86.5	83.8	82.8	112.3	96.9	92.9	87.6	82.0
Percent change	1.7	35.6	-15.9	-12.1	-4.4	-12.7	-11.7	-4.7	-21.6	-13.6	-4.2	-5.7	-6.4

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz.

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REAL ESTATE OUTLOOK

Vol. 1, No. 12
December 1988

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The U.S. Department of Commerce recently updated its advance estimate of real (inflation-adjusted) GNP growth for the third quarter, raising the estimated annual growth rate from 2.2 percent to 2.6 percent. The faster pace of economic growth was due to a higher estimate of consumer spending and a slightly faster rate of business inventory accumulation.
- The updated GNP report also confirmed that the rate of inflation has not accelerated: inflation, as measured by the GNP price deflator, advanced at a 4.7 percent annual rate in the third quarter, somewhat less than the 5.5 percent annual rate of the second quarter.
- Since the election, yields on short-term securities have risen to their highest levels in more than three and a half years. The result has been a near flattening of the yield curve, as yields on three- and six-month Treasury bills have moved within less than 1 and 1/2 percentage points of the 30-yr. Treasury bond yield.
- Higher short-term interest rates have raised the cost of funds for U.S. banks, which led them in late November to boost the prime rate to 10.5 percent from 10.0 percent. While a prime rate increase does not automatically feed into mortgage rates, consumers with home equity loans or lines of credit which have adjustable interest rates tied to the prime rate could see a rise in their loan payments.
- Total housing starts jumped 7.2 percent in October to a seasonally adjusted annual rate of 1.554 millon units. Starts of single-family homes were largely responsible for the October gains, rising 10 percent to a seasonally adjusted annual rate of 1.146 million units.
- Lower interest rates helped existing single-family home sales continue their surprisingly strong pace of 1988 into the month of October. In October, existing single-family home sales reached an annual rate of 3.63 million units, 1.1 percent below the revised September annual rate of 3.67 million units, but 4.6 percent faster than during October 1987.

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- **A New Year's Card: Economic Commentary, by C.D. Ickens**
- **Outlook for the Economy and Real Estate, by Sean A. Burns and Beth M. Maerz**
- **Providing Home Financing Information: What Role for Real Estate Brokers? by John Simonson**

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A NEW YEAR'S CARD

Economic Commentary

by
C.D. Ickens**

Marley was dead; there was no doubt about that. Scrooge knew not how long it had been since the shade of his partner had come to him in the night. Together they had built the economic forecasting firm of Scrooge and Marley into a giant in the industry, and Scrooge had maintained that reputation by careful attention to detail and sound judgment. When in error, Scrooge was always ready with "extraneous influences;" when correct, he was always read with a press release. Why must Marley now torture him so?

His old friend had promised him three spirits who would, if heeded, save Scrooge from the fate that now tormented the dead Marley. What had he said? Ah yes! "There is yet time, Ebeneezer, to turn away from the errors of your forecasts and live as a credit to humanity." What rot, thought Scrooge. When forecasters went about their business, the world was better off. Errors, indeed!

But still, Scrooge had been wakened by first one and then another spirit who showed him what was and what had been. He had seen himself in his younger more carefree days in the university, where forecasters gamboled with each other and traded models and numbers, unencumbered by the awesome responsibilities of the world. Scrooge had rejected that life, because he knew in his heart that the world -- the real world -- wanted and needed his numbers. But, the spirit had also shown him the results of that decision and the decisions of others who had forsaken their proper milieu for the wider world. In particular, Scrooge saw how his predictions and those of other forecasters fell within 10 percent of actual real growth in only three of the past ten years. In fact, Marley's demise was a direct result of the fiasco in 1982 when the forecasters called for 2 percent real GNP growth even as the economy shrank by 2.5 percent.

The second spirit had visited a shaken Scrooge and shown him the world as it was. He saw stable interest rates and a falling dollar and a stock market recovering from a nearly disastrous crash. He saw monetary policy tuning the economy to a 3 percent growth rate in the last quarter of the year. He saw all those things that he himself had predicted could never be happening at the end of 1988: moderate inflation, strong consumer spending, falling unemployment. Humbug! thought Scrooge as he lay awake waiting for the final spirit to show him yet another vision. We simply can't have moderate interest rates and inflation in a world of multi-billion dollar deficits and exploding consumer debt. By all that's good and holy, my models tell me it cannot happen!

As the hall clock struck yet again, Scrooge's bedroom was filled with light and wind and he heard -- no, not heard, rather *felt* -- the presence of the last spirit promised by Marley. He was drawn from his bed and whisked away to what appeared to be an enormous shopping mall. As the spirit motioned, he saw his computer programmer, Bob Cratchit, with his wife buying a compact disk player and a video camera. He followed them in wonder as they made their way to the auto dealer next door and bought a new car.

"Spirit," said Scrooge, his voice quaking with disbelief. "How can Cratchit buy these things? I know personal income has gone up only barely more than prices this year. I've followed that series since my graduate student days. And I know that he and his like are more in debt relative to income than they have ever been. Yet the Cratchits are using credit cards and borrowing to pay for these things they buy."

The spirit motioned silently to the cover of a *Wall Street Journal* lying nearby and a story dealing with the stock market recovery and surging home values. Through some metaphysical process, Scrooge understood that the consumer debt figures and the federal deficit that had figured so heavily into his forecast for 1989 were of little relevance. In fact, the stock market crash had not wiped out consumer wealth. The gains from the surging Dow since 1985 were still there. Cratchit and his peers had bought into the market through mutual funds -- including the 401(k) plan Scrooge had established for his employees in a moment of weakness -- and were enjoying expanding real wealth that allowed them to buy all this electronic gadgetry. And special financing rates and the falling dollar were bringing Bob and his ilk to dealers selling *American* cars.

"Spirit," said Scrooge in a voice that was now little short of a whine, "Are these the shadows of things what *will* be, or of what *might* be? Does this mean that the consumer will not go away, that growth will remain strong through 1989, with low interest rates and moderate inflation? Is my forecast of the coming recession wrong yet another year?"

The spirit nodded gravely and Scrooge began to realize the full import of Marley's message. Expansions do not collapse of their own weight when there are no good reasons for them to do so. If consumers will spend and deficits are trimmed and imports curbed, then the economy could continue to grow in a steady manner, interest rates and inflation could stay down and unemployment would ease.

The spirit left and Scrooge awoke in his bed, chastened but refreshed. He dressed quickly and rushed through the town, wishing all the happiest of New Years. That afternoon he changed his forecast for 1989 and -- now a true believer -- bought a new Buick and a thousand acres of real estate.

**EDITOR'S NOTE: Our usual columnist, John Tuccillo, exhausted by the rigors of the Annual Convention, has asked a guest writer to prepare this month's commentary. His regular column will appear next month.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

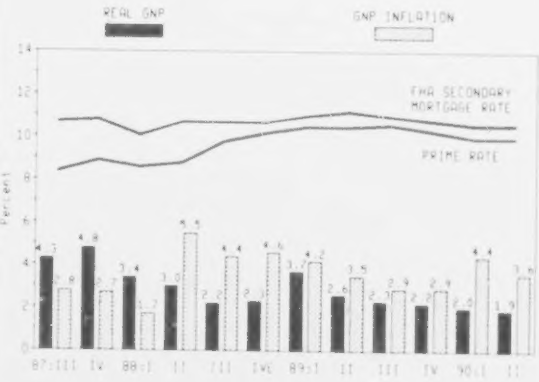
The U.S. Department of Commerce recently updated its advance estimate of real (inflation-adjusted) GNP growth for the third quarter, raising the estimated annual growth rate from 2.2 percent to 2.6 percent. The faster pace of economic growth was due to a higher estimate of consumer spending and a slightly faster rate of business inventory accumulation. Partially offsetting these upward revisions, net exports (exports minus imports) detracted a bit more from third quarter growth than was originally estimated, as imported goods continued to attract the dollars of American consumers. The updated GNP report also confirmed that the rate of inflation has not accelerated: inflation, as measured by the GNP price deflator, advanced at a 4.7 percent annual rate in the third quarter, somewhat less than the 5.5 percent annual rate of the second quarter.

Other economic indicators, such as the monthly reports on employment, industrial production and retail sales, suggest the economy will continue to expand into 1989. Industrial production expanded by 0.4 percent in October, marking the eigth consecutive monthly advance. Meanwhile, retail sales surged 0.9 percent to $135.6 billion, the largest monthly increase since March. Over the last several months, mixed reports from retail establishments has led some analysts to speculate that the economy is slowing down. However, the October gains were widespread, including large increases in auto sales and other consumer durables, as well as in nondurable consumer goods. In addition, consumer confidence in October was reported to be at its third highest level during the current expansion. Instead of concerns over an economic slowdown, attention has focused again on the prospects for an accelerating rate of inflation. Peaking operating rates, already at a nine year high, could very easily lead to higher wage demands and faster rates of price increases. But domestically driven inflation is not the only possible source of higher prices. Continued improvement in the U.S. trade deficit will likely require further declines in the dollar, which could lead to consumers paying higher prices for U.S. imports.

Monetary Policy and Interest Rates

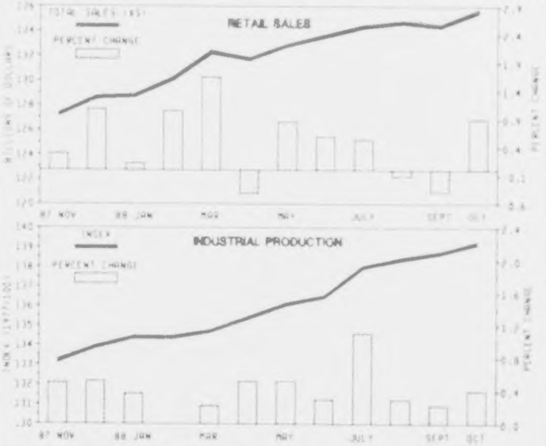
Inflationary concerns at the Federal Reserve may have been eased somewhat by the moderate 2.6 percent third quarter growth rate. However, the jump in retail sales and continued high operating rates amid strong employment growth have undoubtedly kept the Fed searching for the first signs of a resurgence of inflationary pressures. In addition, the dollar has fallen considerably since its Summer rally, having peaked in September. This has brought heavy intervention by the Japanese central bank and the Fed to keep the dollar from falling below the 120 - 125 yen range. In this environment of inflationary pressures bubbling to the surface on both the domestic and international fronts, the Fed has sought to keep credit dear and short-term interest rates rising. Since the election, yields on short-term securities have risen to their highest levels in over three and a half years. The result has been a near flattening of the yield curve, as yields on three- and six-month Treasury bills have moved within less than 1 and 1/2 percentage points of the 30-yr. Treasury bond yield.

GRAPH 1: THE ECONOMIC OUTLOOK



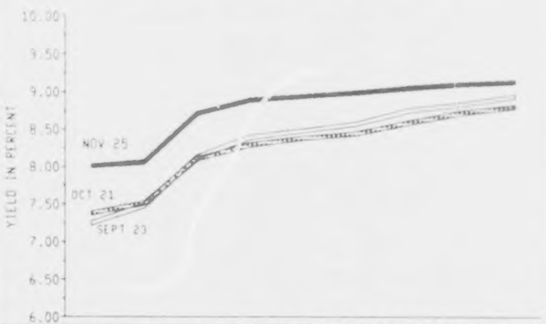
E NAR **estimates**(1988:III thru 1989:IV)

GRAPH 2: PRODUCTION & RETAIL SALES RISE



SOURCE: Bureau of Labor Statistics.

GRAPH 3: RISING SHORT RATES, STABLE LONG RATES FLATTEN YIELD CURVE



	3 Month	6 Month	1 Year	2 Year	3 Year	5 Year	7 Year	10 Year	30 Year
NOV 25	8.01	8.06	8.71	8.89	8.94	8.99	9.05	9.10	9.13
OCT 21	7.38	7.51	8.10	8.29	8.38	8.44	8.59	8.72	8.80
SEPT 23	7.25	7.48	8.13	8.39	8.48	8.57	8.75	8.83	8.94

SOURCE: Generale de Banque, New York.

At the time this newsletter went to print, the yield on two-year Treasury notes was only about one-quarter of one percentage point less than 30-year Treasury bonds, whereas, one year ago this gap was about 1 and 1/2 percentage points. Higher short-term interest rates have raised the cost of funds for U.S. banks, which led them in late November to boost the prime rate to 10.5 percent from 10.0 percent. This rise was not a market leading move, but rather confirmed what had already taken place on the short end of the yield curve. A prime rate increase does not automatically feed into mortgage rates. However, consumers with home equity loans or lines of credit which have adjustable interest rates tied to the prime rate could see a rise in their loan payments.

Despite the rise in short-term interest rates, long-term interest rates in the U.S. and around the world have remained relatively stable in recent weeks. This is not to say that inflation fears only affect short-term rates; they affect long-term rates directly. However, expectations regarding the future rate of inflation appear to have been already factored into these long-term rates, possibly for several months.

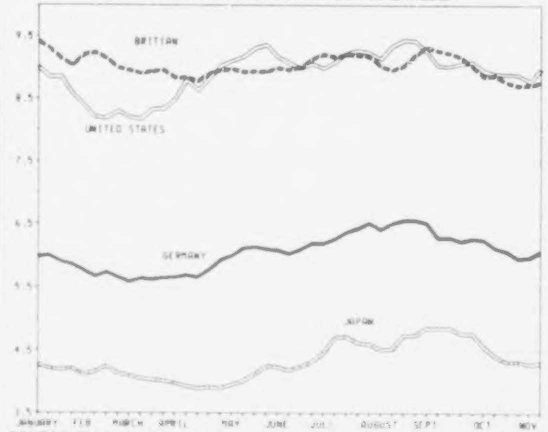
The recent rise in short-term rates is due to a growing concern that if future indicators show the economy advancing above its trend rate of growth, the Fed will have to act strongly to keep inflation under control. For example, an advance of more than 300,000 jobs recorded in the employment report (due out December 2) could be just such an indicator that might force the Fed to raise short-term rates even higher. If short-term rates continue to rise with stable long-term rates, then the yield curve could become inverted: higher short-term rates than long-term rates. More likely, if the Fed aggressively moves short-term rates higher, long-term rates would gradually follow as inflation expectations intensify.

REAL ESTATE MARKETS

Housing Starts

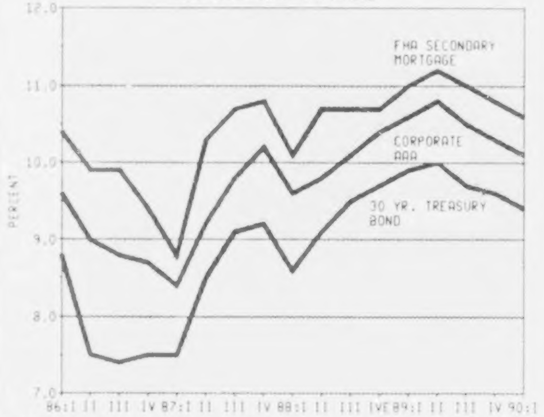
Total housing starts jumped 7.2 percent in October to a seasonally adjusted annual rate of 1.554 millon units. The October rate, which marked the largest monthly increase in housing starts since February, was only slightly above the October 1987 rate of 1.538 million units. Starts of single-family homes were largely responsible for the October gains, rising 10 percent to a seasonally adjusted annual rate of 1.146 million units. This was the strongest pace since September 1987 when single-family starts reached a rate of 1.211 million units. Starts of structures with two to four units mirrored single-family starts, rising 10.6 percent in September to an annual rate of 73 thousand units. Multi-family starts with five or more units were weak, falling 1.6 percent to a seasonally adjusted annual rate of 335 thousand units. The increased activity in single-family housing starts was due to low interest rates in September and October. The expected steady rise in mortgage interest rates into the first half of 1989 suggests that starts of single-family units will not surge forward. Rather, single-family starts are expected to average an annual rate of about 1.01 million units in 1989, down only marginally from their 1988 projected total of 1.08 million units.

GRAPH 4: LONG-TERM INTEREST RATES HOLD STEADY AROUND THE WORLD



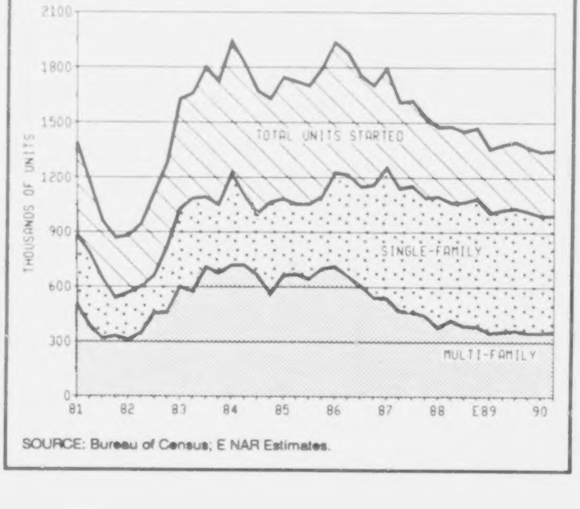
SOURCE: The Federal Reserve Board.

GRAPH 5: FORECAST FOR U.S. LONG-TERM INTEREST RATES



SOURCE: The Federal Home Loan Bank Board..

GRAPH 6: HOUSING STARTS



SOURCE: Bureau of Census; E NAR Estimates.

Existing Home Sales

Lower interest rates helped existing single-family home sales continue their surprisingly strong pace of 1988 into the month of October. In October, existing single-family home sales reached an annual rate of 3.63 million units, 1.1 percent below the revised September annual rate of 3.67 million units. However, existing single-family homes were sold at a rate 4.6 percent faster than during October 1987, when homes were sold at a seasonally adjusted annual rate of 3.47 million units. The October 1988 rate of 3.63 million units was considerably faster than the 3.45 million unit pace of the first six months of the year, and still stronger than the January through September average annual rate of 3.52 million units. Heading into the fourth quarter, even the seasonally adjusted rate of existing home sales will exhibit the normal cycle of slower home sales that extends through the winter months of the fourth and then the first quarter. The expected rise in mortgage interest rates could cause home sales to fall to 3.38 million units in 1989 and 3.25 million units in 1990; a drop of 3.9 and 3.6 percent, respectively.

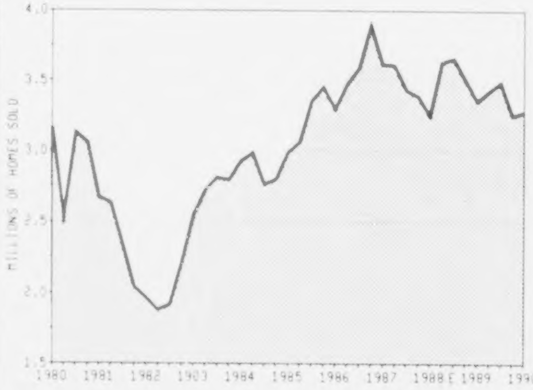
Home Prices

The median sales price of an existing single-family home was relatively unchanged in October at $88,100, down 0.1 percent from the September median price of $88,200. While the October median sales price represents a 4.1 percent rate of appreciation over the October 1987 price of $84,000, it is the third consecutive monthly decline, and it represents the lowest median price reported since April of this year.

Since data on new single-family home sales and prices was due out later than the printing deadline of this newsletter, we instead look at the trend of rapidly rising new home prices. This trend has been impressive: the median sales price of new single-family homes increased 12.9 percent in 1987, and an expected 10.2 percent in 1988. However, these gains in the median price (the price at which there are an equal number of houses priced above as there are below) have been caused not only by inflationary pressures, but also the changing types of new homes that are being sold. In the past decade, the gap between the median and average cost of a new home has widened considerably, with the average price rising more rapidly than the median. This growing price gap means that new homes in the higher price brackets are being priced above the median by an increasing margin. This is partly due to the practice of many builders to offer homebuyers the ability to customize their homes by selecting from expensive options.

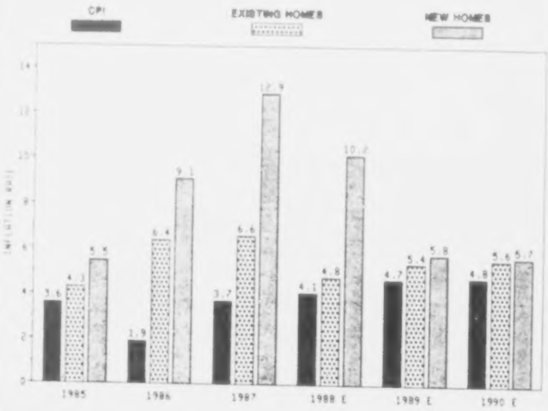
This trend is most apparent in the way that the average price of a new home has risen far above the quality-adjusted new home price index. (This index accounts for the quality differences of new homes by tracking the cost of a new home with ten consistent characteristics, thus isolating the real price changes. Its base year is 1982.) The failure of the price index to keep pace with the average price of a new home could indicate that, on average, today's new homes are more desirable in terms of these ten benchmark characteristics, and that they likely contain more of the fancier and higher priced options mentioned earlier.

GRAPH 7: EXISTING SINGLE-FAMILY HOME SALES



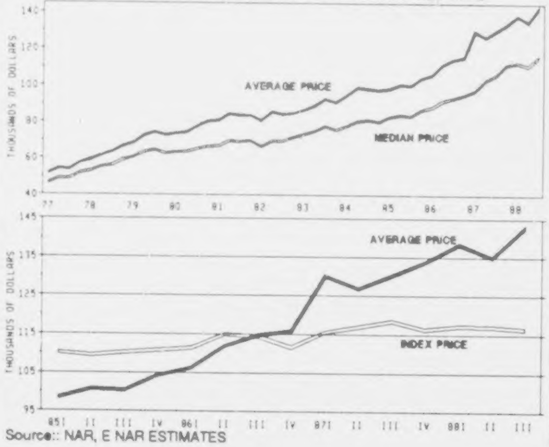
Source: Bureau of Census; E NAR Estimates

GRAPH 8: HOME PRICES



Source: Bureau of Census.; E NAR Estimates.

GRAPH 9: BEHIND THE TREND OF ESCALATING NEW SINGLE-FAMILY HOME PRICES



Source:: NAR, E NAR ESTIMATES

REGIONAL DATA

Housing Starts

With the exception of the Northeast, housing starts rose in every region during October. Housing construction activity in the West continues to be exceptionally strong, with starts reaching 498 thousand units in October, 15 percent above the September annual rate of 433 thousand units, and 21.2 percent above the October 1987 annual rate of 411 thousand units. Housing starts in the Midwest rose to an annual rate of 268 thousand units, 7.6 percent above the September annual rate of 249 thousand units, and 6.8 percent above the October 1987 rate of 251 thousand units. In the South, housing starts reached an annual rate of 586 thousand units in October, 4.6 percent above the September rate of 560 thousand units, but 5.8 percent below the October 1987 rate of 622 thousand units. In sharp contrast, housing starts in the Northeast continued to sag, falling in October to a seasonally adjusted annual rate of 202 thousand units, or 2.4 percent below the September annual rate of 207 thousand units, and 20.5 percent below the 254 thousand unit pace of October 1987. Housing starts (not seasonally adjusted) for the first ten months of 1988 have fallen short of their 1987 levels for the same period: 206 thousand units in the Northeast, down 11.6 percent from 1987; 235 thousand units in the Midwest, down 9.3 percent; 492 thousand units in the South, down 10.9 percent; and 347 thousand units in the West, down 6.3 percent.

Existing Home Sales

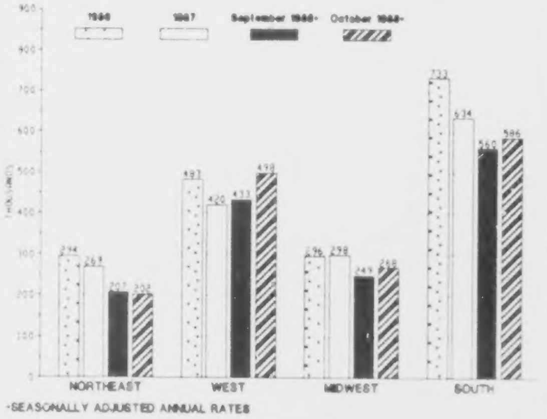
The regional breakdown of existing single-family home sales in October looked very much like the September data, with only moderate changes occuring in the Midwest and the West. October sales in the Midwest reached 930,000 homes, up 2.2 percent from both the September 1988 and October 1987 annual rate of 910,000 homes. Existing single-family home sales slowed to 700,000 homes in the West, down 2.8 percent from the September rate of 720,000 homes, but 16.7 percent above the October 1987 rate of 600,000 homes. In the South and the Northeast, existing single-family home sales were unchanged at 1,390 and 650 thousand unit annual rates, respectively.

Home Prices

The fall in the median sales price of an existing single-family home was shared by the Northeast and West, while prices in the South and Midwest rose slightly. The median price in the Northeast fell 2.8 percent in October to $137,600, but this was 1.7 percent above the October 1987 median price. In the West, the October median price fell 3.0 percent to $124,400, but this was 6.9 percent above the October 1987 median sales price. Home prices inched up in the Midwest by 0.8 percent to $67,600, an increase of 6.0 percent from a year ago. In the South, the median priced home sold for $81,600, up 0.8 percent from September and 1.7 percent from last October.

Sean A. Burns,
Director of Forecasting
Beth M. Maerz,
Research Associate
Forecasting & Policy Analysis Division

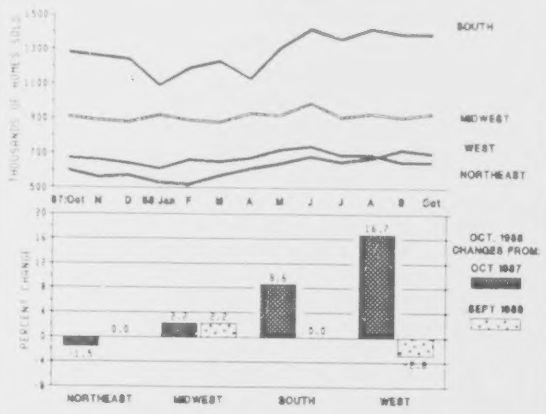
GRAPH 10: HOUSING STARTS BY REGION



*SEASONALLY ADJUSTED ANNUAL RATES

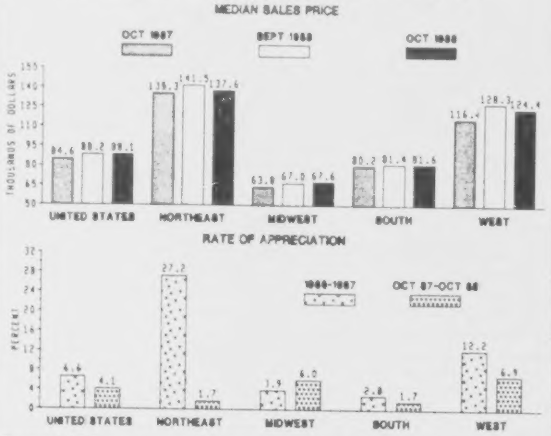
Source: NAR Economics and Research; E NAR Estimates

GRAPH 11: EXISTING SINGLE-FAMILY HOME SALES BY REGION



Source: NAR Economics and Research.

GRAPH 12: HOME PRICES BY REGION



Source: NAR Economics and Research; E NAR Forecasting & policy.

PROVIDING HOME FINANCING INFORMATION: WHAT ROLE FOR REAL ESTATE BROKERS?

Homebuyers' Need for More and Better Financing Information

ARMs, FRMs, GPMs, VRMs, PLAMs, and a multitude of other seemingly esoteric options confront today's prospective homebuyer in shopping for a home mortgage loan. Not surprisingly, obtaining reliable and comprehensible information about alternative financing packages available can be a vexing obstacle to homeownership for many American families. Real estate brokers already play an important role in providing such information to prospective homebuyers; from all indications that role is more likely to grow than to diminish.

Just how great is the need for more and better information about home financing is revealed by a 1987 Gallup survey commissioned by The Travelers Mortgage Services, Inc.[1] Among current homeowners, for example:

- Nearly three in five (58.1%) believed that shopping for a mortgage should occur before selecting a home.
- Over one-third (38.7%) said they were not even "somewhat" knowledgeable about home financing.
- Some two out of five (43.1%) either agreed with the statement "the monthly payment on a fixed-rate 15-year mortgage is twice the payment on a fixed-rate 30-year mortgage" or did not know whether or not the statement is true.
- Nearly one-fourth (23.2%) either did not believe or did not know that mortgage interest rates and points may be negotiable.

In sum, a sizeable number even of current homeowners seem to know surprisingly little about mortgage terms and other facets of the home financing process. And indications are that the situation among prospective first-time homebuyers is substantially worse.

Sources of Finance Information

Prospective homebuyers appear to seek financing information from many sources. The following table shows the respective percentages of current homeowners and of prospective first-time homebuyers which indicated they were "most likely" to use each of several alternative sources to obtain information regarding housing finance. As might be expected, current homeowners would turn primarily to lending institutions for home financing information, indicating that thrifts and banks are by far the "most likely" source. Real estate brokers are the second most relied upon source, followed in order by magazines/newspapers/TV, friends/relatives, and lawyers.

Information Source	Current Owners "Most Likely" to Use Source*	Prospective First-Time Homebuyers "Most Likely" to Use Source*
Lending Institutions:		
Banks/Savings & Loans	34.4	23.6
Mortgage Companies	13.2	8.1
Credit Unions/Finance Cos	9.4	6.8
Real Estate Agents/Agencies	30.7	33.7
Magazines/Newspapers/TV:		
Advertisements	13.2	20.1
Articles	11.9	14.5
Friends/Relatives	13.2	16.6
Lawyers	14.3	13.0
Other/Don't Know	4.8	4.1

* Totals exceed 100% because some respondents indicated they were likely to use more than one source.

A Special Problem for First-Timers

Among *prospective first-time* homebuyers[2] the home finance process can be especially intimidating. Three out of four in this category (74.2%) believe the mortgage should be shopped for before selecting a home. Moreover, prospective first-time buyers are far less likely to obtain financing information from lenders than are current owners. Instead, prospective first-time homebuyers are somewhat more likely to rely on magazines, newspapers, and TV and on real estate brokers.

Good Information as Valuable as Low Rates?

There can be little doubt that selecting appropriate financing constitutes a critically important component of the home purchase process. We have already seen, for example, that the overwhelming majority of prospective homebuyers feels that shopping for a mortgage should occur before shopping for a house. But how respondents rated importance of factors in selecting a financing package is particularly revealing. Among current homeowners, 74.1 percent said that "knowledgeable and helpful staff" is very important, compared with 86.8 percent who said "best available rates" is a very important factor. Among prospective first-time homebuyers *more* cited "knowledgeable and helpful staff" as being very important than cited "best available rates" (84.1% vs. 76.7%).

We can undoubtedly expect continued proliferation of alternative mortgage instruments, interest rate volatility, and increased home financing complexity. Therefore, gaining essential information about home finance is unlikely to become any less critical or any less intimidating for prospective homebuyers than it is now. Real estate agents already serve as an important source of financing information for a large proportion of homebuyers. But the opportunity remains for real estate agents to play an even larger role in the future.

---

1. Between March 10 and April 3, 1987, The Gallup Organization conducted a telephone survey of adults aged 26 to 65 in 16 metropolitan areas in the United States. The survey, commissioned by The Travelers Mortgage Services, Inc., was based on a sample of 1001 current owners, 81 current renters who previously owned, and 130 current renters who were actively preparing to purchase for the first time.
2. "Prospective first-time homebuyers" are adult respondents surveyed who currently rented, had not previously owned, and who were actively preparing to buy a home, e.g., saving for a down payment, dealing with a real estate broker, or reading "homes for sale" brochures.

by
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University of Wisconsin-Platteville
Visiting Scholar at the
NATIONAL ASSOCIATION OF REALTORS®

U.S. ECONOMIC OUTLOOK

DECEMBER 1988

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	88.2	88.3	88.4	89.1	89.2	89.3	89.4	90.1	1986	1987	1988	1989	1990
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4824	4909	4984	5080	5157	5223	5290	5373	4240	4527	4858	5187	5494
% Change	8.7	7.2	7.1	8.0	6.1	6.4	5.2	6.5	5.6	6.8	7.3	6.8	5.9
% Change (w/out inflation)	3.0	2.6	2.3	3.7	2.6	2.3	2.2	2.0	2.8	3.4	3.8	2.7	2.2
Consumer Price Inflation (CPI)	4.8	4.7	4.4	4.9	4.8	4.6	4.6	5.4	1.9	3.7	4.1	4.7	4.8
GNP Inflation (GNP Deflator)	5.5	4.4	4.6	4.2	3.5	2.9	2.9	4.4	2.7	3.3	3.3	4.0	3.6
Unemployment Rate - Civilian	5.4	5.5	5.3	5.4	5.5	5.5	5.5	5.5	7.0	6.2	5.5	5.5	5.6
Civilian Employment-Household Basis (millions)	114.6	115.2	115.8	116.1	115.5	117.0	117.5	117.9	109.6	112.4	115.0	116.8	118.4
Percent change	1.5	1.9	2.1	1.0	1.7	1.6	1.6	1.3	2.3	2.6	2.2	1.6	1.4
Index of Industrial Production	136.0	138.2	139.5	139.6	140.3	141.1	141.9	142.2	125.1	129.8	137.1	140.7	143.3
Manufacturing Capacity Utilization	83.2	83.8	83.9	83.9	83.8	83.9	83.8	83.6	79.7	81.0	83.4	83.8	83.7
Domestic Auto Sales	7.5	7.6	7.3	7.2	7.2	7.2	7.2	7.0	8.2	7.1	7.5	7.2	7.0
Federal Tax Receipts (NIPA) as % of GNP	20.4	19.8	19.9	20.0	20.1	20.1	20.1	20.6	19.5	20.2	20.1	20.1	20.6
Federal Expenditures (NIPA) as % of GNP	23.1	22.4	22.7	22.9	22.9	22.8	22.8	22.9	24.4	23.7	22.9	22.9	22.9
Deficit(NIPA)	-133.3	-127.1	-140.5	-147.8	-144.3	-142.1	-144.0	-122.2	-205.6	-157.8	-139.0	-144.6	-124.6
as % of GNP	-2.8	-2.6	-2.8	-2.9	-2.8	-2.7	-2.7	-2.3	-4.9	-3.5	-2.9	-2.8	-2.3
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4674	4702	4603	4352	4430	4487	4233	4238	4712	4648	4573	4376	4232
Percent change – year ago	-0.5	3.8	3.5	-2.0	-5.2	-4.6	-8.0	-2.6	10.8	-1.4	-1.6	-4.3	-3.3
Existing Single-family Home Sales (thousands)	3643	3670	3550	3375	3437	3486	3250	3276	3565	3526	3528	3378	3255
Percent change – year ago	0.9	7.0	4.7	3.8	-5.7	-5.0	-8.5	-2.9	10.9	-1.1	0.1	-4.0	-3.9
Housing Starts (thousands)	1481	1462	1471	1357	1381	1395	1364	1342	1812	1634	1470	1374	1366
Percent change – year ago	-7.8	-9.7	-4.1	-8.1	-6.7	-4.5	-7.3	-1.1	4.1	-9.8	-10.0	-6.5	-0.6
Single-Family Units	1063	1062	1086	1007	1024	1032	1013	992	1183	1157	1078	1019	1007
Percent change – year ago	-6.5	-7.8	-0.3	-8.2	-3.7	-3.0	-6.7	-1.5	10.4	-2.2	-6.8	-5.4	-1.2
Multi-Family Units	418	399	385	350	357	363	350	350	630	477	393	355	358
2-4 Family Units	57	59	58	52	54	54	52	52	85	66	57	53	54
Percent change – year ago	-20.4	7.3	2.3	-7.0	-6.7	-8.5	-9.0	0.0	-9.0	-22.6	-12.7	-7.4	1.0
5 + Family Units	360	340	327	297	304	308	298	297	545	412	336	302	305
Percent change – year ago	-9.1	-16.6	-15.4	-8.1	-15.7	-9.4	-9.0	0.0	-5.6	-24.4	-18.5	-10.1	1.0
New Single-family Home Sales (thousands)	697	705	660	607	620	660	570	550	750	671	673	614	563
Percent change – year ago	3.4	4.4	6.3	-3.7	-11.0	-6.4	-13.6	-9.4	9.0	-10.5	0.3	-8.7	-8.3
Mobile Homes Shipped (thousands)	220	216	227	218	222	226	230	228	246	233	218	224	233
HOME PRICES													
Existing Home Prices - Median $(1000)	88.9	90.1	91.9	92.6	94.3	95.1	96.0	97.1	80.3	85.6	89.7	94.5	99.8
Percent change – year ago	4.5	5.4	8.1	5.5	6.1	5.5	4.5	4.9	6.4	6.6	4.8	5.4	5.6
New Home Prices - Median $(1000)	112.9	115.5	117.0	117.4	121.3	122.5	123.7	124.9	92.0	104.0	114.6	121.2	128.1
Percent change – year ago	9.1	8.8	4.7	4.0	7.4	6.1	5.7	6.4	9.1	12.9	10.2	5.8	5.7
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.7	10.7	10.7	11.0	11.2	11.0	10.8	10.6	9.9	10.2	10.5	11.0	10.7
1-year ARM (without buydown)	7.6	7.6	7.8	8.1	8.2	8.2	8.3	8.1	7.9	8.2	7.6	8.2	7.8
Corporate AAA Bond Rate	9.8	10.1	10.2	10.4	10.6	10.5	10.3	10.1	9.0	9.4	10.0	10.6	10.2
Government Bond Rate	9.1	9.5	9.3	9.7	9.9	9.7	9.6	9.4	7.8	8.6	9.2	9.8	9.4
Short-Term Interest Rates													
Federal Funds Rate	7.1	8.1	8.3	8.5	8.7	8.6	8.3	8.3	6.8	6.7	7.6	8.5	8.0
3-month T-Bill Rate	6.2	7.2	7.9	8.1	8.3	8.0	7.8	7.6	5.8	6.6	7.6	7.1	
Prime Pate	8.8	9.8	10.2	10.5	10.5	10.3	10.0	10.0	8.3	8.2	9.4	10.5	9.7
Discount Rate	6.0	6.4	6.6	7.0	7.0	7.0	6.8	6.5	6.3	5.7	6.3	6.5	6.7
Value of the U.S. Dollar (Trade-Weighted Avg.)	90.4	97.6	93.5	90.5	89.4	86.4	83.8	82.8	112.3	96.9	92.9	87.5	82.0
Percent change	1.7	35.6	-15.8	-12.0	-4.7	-12.9	-11.7	-4.6	-21.6	-13.6	-4.2	-5.8	-6.3

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz.

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REAL ESTATE

Vol. 2, No. 1

OUTLOOK

January 1989

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The U.S. Department of Commerce made relatively few changes in December to its estimate for third quarter real GNP growth; the final estimate is now at 2.5 percent, virtually unchanged from the prior estimate of 2.6 percent. However, while the pace of economic growth may be slowing down, the economy still maintains a hearty head of steam heading into 1989.
- The November employment report showed a surprisingly large advance in employment of 463 thousand new jobs. This employment report adds to the list of indicators that the economy may be growing too quickly, and that inflationary pressures could be mounting.
- The Federal Reserve tightened credit in December in response to higher foreign interest rates, a softer dollar, and continued strong U.S. economic growth.
- Starts of privately owned homes reached a seven month high in November at a seasonally adjusted annual rate of 1.563 million units, up 1.4 percent from the October revised pace of 1.542 million units.
- Following a revised 1.4 percent drop in September (previously estimated at negative 7.8), new single-family home sales rose by 3.5 percent in October to a seasonally adjusted annual rate of 733 thousand units, marking the fastest pace since February 1987.
- Sales of existing single-family homes rose to a seasonally adjusted annual rate of 3.71 million units in November, 1.1 percent above the October 1988 annual rate of 3.67 million units.
- The median sales price of an existing single family home fell slightly in November to $87,900, 0.2 percent below the October median sales price of $88,100, and 3.4 percent above the November 1987 median price of $85,000.

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- **Outlook for the Economy and Real Estate, by Sean A. Burns and Beth M. Maerz**

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A Revolutionary Prospect

Economic Commentary

by
John A. Tuccillo
Chief Economist and
Senior Vice President
Real Estate Finance

When Cornwallis' defeated army marched from the field at Yorktown, the British band played "The World Turned Upside Down". In fact it had -- the most prosperous, progressive, assimilated of all the colonies in the British Empire had severed itself forever from mother England. If we could bring back Cornwallis' band for an encore after two centuries, it would be appropriate to ask them to play on Wall Street, for in financial markets we have seen the world turn upside down.

Consider corporate securities. Once considered the bedrock of the market, these are now in considerable disrepute. First the crash soured the love affair between the American public and corporate equities. The market will go up and down, and in fact will probably soar during the nineties. But for now, October 19, 1987 changed the way investors look at stocks. The debt side is hardly more encouraging. Leveraged buyouts, with their associated massive bond issues, have made the staid old corporate bond market suspect. Where once quality was assumed, now nothing is certain. In fact, the current debt sweethearts are brazen hussies like junk bonds and dowdy spinsters like Federal government paper.

But the real inversion has taken place among financial intermediaries. During this decade, we have seen shattered all the comfortable truths we associated with the word "bank." The farm crisis, the collapse of oil prices and the inability of the developing world to develop have sapped the capital strength of large commercial banks and forced the closing of scores of others. The result has been a disenchantment with and exodus from the banks to their investment fund substitutes, just as the major broadcast networks have lost viewers to the cable systems.

The problems of the banks, though, pale in comparison to the immediacy and looming cost of the savings and loan industry. It's ironic that those institutions set up "to encourage thrift and promote homeownership" are bankrupt and unable to put their own house in order. Now, the papers are so full of fingers pointing out who's to blame for this that one would think the industry has absorbed the entire Dukakis campaign staff. But the issue is complex, and as we slouch toward a public expenditure of considerable size to bail out the industry, it is worthwhile to look at the variety of causes that brought us here.

In reality, the thrift crisis is not the result of a single cabal, but rather the complex interaction of at least four factors. *Deregulation* permitted the thrifts to wander off the reservation and engage in lines of business for which they were ill-equipped. In a more subtle vein, the detailed regulatory structure that limited financial institutions prior to 1980 created excessive numbers of banking firms. Per capita, the U.S. has over 100 times the number of depositories as Canada (and that excludes credit unions). When the regulatory straitjacket was removed, the industry had to consolidate.

Fraud and mismanagement were clearly present in the industry. In the eighties a number of sharp operators, who saw how to use the relatively lax regulatory and examination systems to their personal gain, got into the industry. Their entry was eased by the vacuum resulting from weak management throughout the industry. Put simply, when the world turned upside down, many thrift managers found themselves ill-equipped to deal in modern financial markets, and their institutions suffered.

Finally, *regional depression* added a final nail to the coffin. In the Southwest, where construction plans went forward on the assumption that oil prices in dollars would match the last two digits of the year, many loans that looked good at closing soured very quickly. When the oil and farm economies collapsed, a significant number of institutions were doomed. Of course, all four of these factors have an interactive effect, and the worst cases exhibited more than one symptom.

So where does this leave us? Well, in the new financial system, regardless of who pays for the thrifts and how much it costs, there are simply going to be fewer institutions dedicated by charter to finance real estate. What institutions survive may specialize in traditional thrift areas but this will be by *choice* rather than *mandate*. But that doesn't mean a return to the bad old days when the mortgage market was isolated and treated by policy makers as a can of silly putty. Rather the place of the thrifts has been, and will be, taken by a spectrum of investors, originators and services ranging from Fannie Mae and Freddie Mac down to individual investors purchasing mortgage securities through their brokers.

REALTORS® need to recognize these changes and understand they need to traverse a whole new financial landscape. Funds will be available at the market, but often through sources previously unrecognized. Just as financing is the key to sales, seeing this overturned world is the key to finance. After all, we'd much rather be Washington than Cornwallis.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

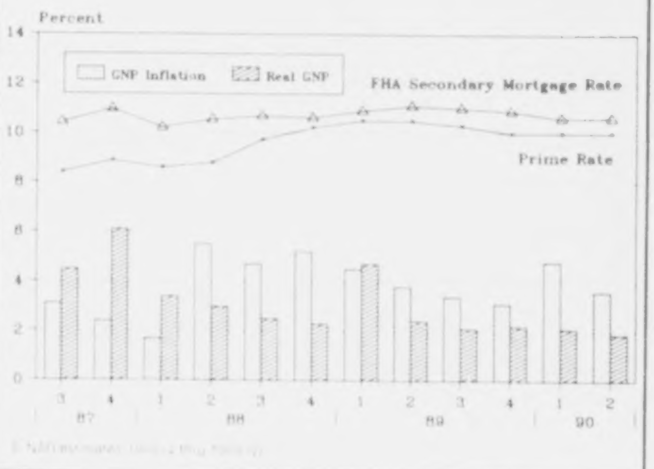
With all the changes that a new year typically brings, economic growth appears to be one of the few constants, as the economy appears poised to continue its record peacetime expansion through 1989. The U.S. Department of Commerce made relatively few changes in December to its estimate for third quarter real GNP growth; the final estimate is now at 2.5 percent, virtually unchanged from the prior estimate of 2.6 percent. In 1988, the severe drought pulled down these real GNP estimates because of the lower levels of farm production, but in doing so they obscured the continued strong growth of the non-farm economy in 1988. Concern by the monetary authority about the fast pace of non-farm economic growth is largely responsible for the recent rise in short-term interest rates and the flattening of the yield curve. Specifically, the non-farm sector of the economy alone grew at a robust annual rate of 4 percent in the first half of 1988, and at a 3.3 percent annual rate in the third quarter. Clearly while the pace of economic growth may be slowing down, the economy still maintains a hearty head of steam heading into 1989. In the fourth quarter, economic growth appeared to be moving forward with a great deal of momentum, as indicated by reports of increased retail sales (up 1.1 percent in November), expanding industrial production (up 0.5 percent in November) and strong employment gains.

Job Growth Continues

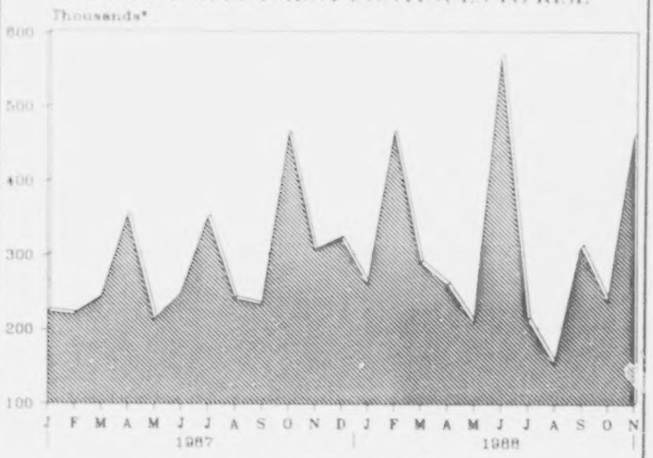
The November employment report showed a surprisingly large advance in employment of 465 thousand new jobs. This employment report adds to the list of indicators that the economy may be growing too quickly, and that inflationary pressures could be mounting. The report undoubtedly raised eyebrows at the Federal Reserve, where the economy is viewed as being at or near a full-employment level. Continued employment growth during times of low unemployment can lead to price increases as employers are forced to offer higher wages in their bid for a limited supply of available workers. At the same time, labor unions can become increasingly confident about making higher wage demands. As we reported last month, employment growth in excess of 300,000 new jobs could lead the Fed to draw credit in even tighter by pushing up short term interest rates; and there is strong evidence that this is exactly what has happened (more on this later). By tightening credit the Fed expects to slow economic growth (including employment growth) in the hopes of keeping the rate of inflation under control.

As Graph 3 shows, the non-farm economy has been growing much more strongly than the recent real GNP growth estimates suggest. However, the rate of non-farm growth is slowing down and approaching the long-term trend rate of growth of 2.5 percent thought to be desired by the Fed. In 1989, economic growth should continue on this path toward a "gentle landing" from the rapid advance of recent years. However, real GNP growth in the first quarter of 1989 will likely reach 4.7 percent as farm production stages a comeback from the depressed levels of the drought. Again, farm production will likely cloud the underlying growth trend of the non-farm economy, but only during the first part of 1989.

GRAPH 1: THE ECONOMIC OUTLOOK



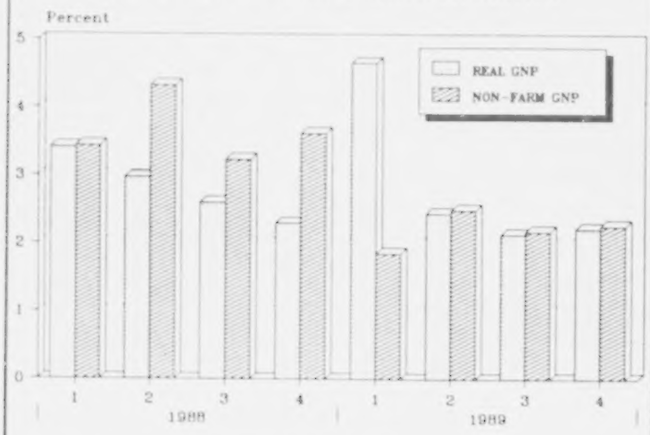
GRAPH 2: EMPLOYMENT CONTINUES TO RISE



SOURCE: Bureau of Labor Statistics.

*Seasonally adjusted increases in non-farm employment.

GRAPH 3: NON-FARM GROWTH SLOWS



SOURCE: Department of Commerce; NAR Estimates.

Monetary Policy and Interest Rates

The Federal Reserve continues to feel the pressure for tighter credit as higher foreign interest rates, a softer dollar, and strong U.S. economic growth keep the heat on. Exchange markets reacted to the $10.3 billion trade deficit in October by pushing the dollar lower, fearing that the deficit improvements made during the beginning of 1988 have stalled. In addition, by the middle of December, all of the major European countries, concerned by the growth rate of their own economies, had followed the Bank of England's lead taken in late November, and raised their official interest rates. Given the anti-inflationary stance of the Fed, the Fed is expected to raise the discount rate from 6.5 percent to 7.0 percent in the very near future in order to keep the dollar from falling any further. In fact, banks have already reacted to these pressures on interest rates by raising their prime lending rate from 10.0 percent in November to 10.5 percent by mid-December.

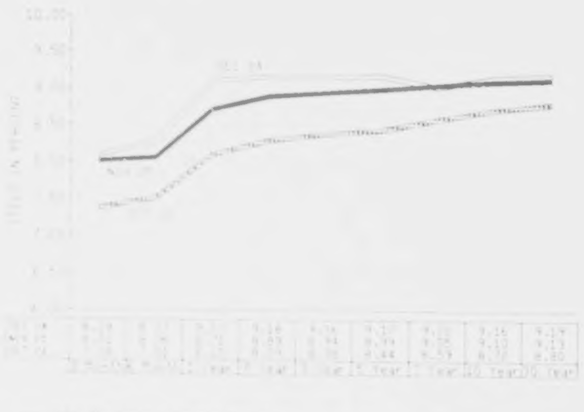
With or without a discount rate hike, the Fed's tightening over the past two months has been evident in the rise of short-term interest rates. The three month Treasury bill has risen from its November average of 7.68 percent to 8.1 percent while the 1-year bill is yielding over 9 percent and is now slightly higher than the 30-year Treasury bond. The result has been a near inversion at the tail end of the yield curve. The yield curve is expected to steepen in the next few months, as the inflation expectations embodied in the short-term rates find move into the long-term rate structure. Mortgage rates have been moving steadily upwards in the past month with the commitment rate on a fixed rated mortgage jumping almost 50 basis points from its November average to 10.75 in December. This rise is expected to continue, peaking by the spring of next year at 11.1 percent.

REAL ESTATE MARKETS

Housing Starts

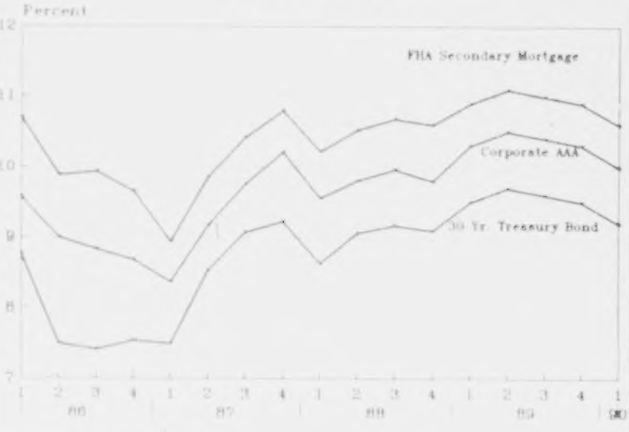
Starts of privately owned homes reached a seven month high in November at a seasonally adjusted annual rate of 1.563 million units, up 1.4 percent from the October revised pace of 1.542 million units. The increased activity in housing starts came as a pleasant surprise, given that starts were expected to slow as homebuyers reacted to the return of higher mortgage rates . It seems that potential homebuyers took the November rise in interest rates into account in their buying decisions; thus prompting many to act ahead of further rate rises. The rise in mortgage rates during December is expected to continue through the spring of 1989, slowing housing activity and lowering starts from 1.48 million units in 1988 to 1.397 in 1989. Starts of single-family homes were up 0.8 percent from October (2.0 percent from a year ago) to a seasonally adjusted annual rate of 1.151 million units, the fastest pace since March of 1988. As for multi-family homes, those with 2-4 units were started at an annual rate of 64 thousand units in November (3.2 percent faster than the October rate and 25.5 percent faster than November 1987), while those with 5 or more units were up 3.0 percent in November to a seasonally adjusted annual rate of 348 thousand units (27.7 percent below November 1987).

GRAPH 4: THE INVERSION OF THE YEILD CURVE



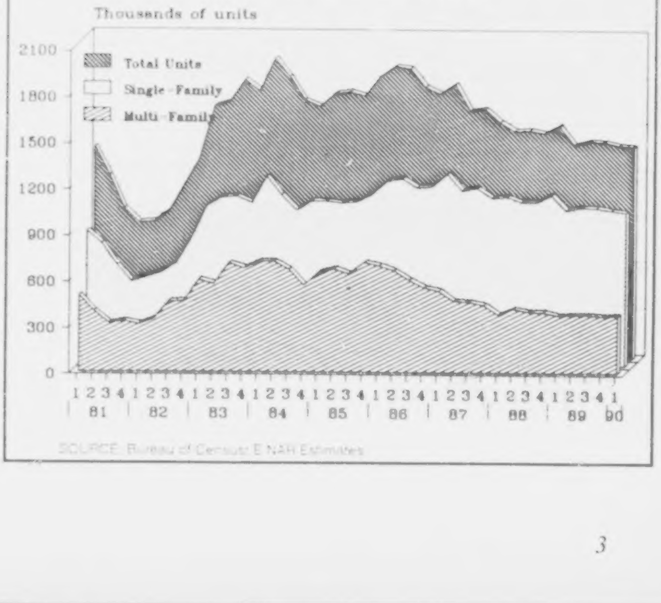
SOURCE: The Federal Reserve Board

GRAPH 5: FORECAST FOR LONG-TERM INTEREST RATES



SOURCE: The Federal Reserve Board

GRAPH 6: HOUSING STARTS



SOURCE: Bureau of Census & NAR Estimates

New Home Sales

Following a revised 1.4 percent drop in September (previously estimated at negative 7.8), new single-family home sales rose by 3.5 percent in October to a seasonally adjusted annual rate of 733 thousand units, marking the fastest pace since February 1987. As discussed last month, housing activity picked up in October following a drop in interest rates, prompting many who correctly anticipated a return to higher rates to move up their home purchases. Regionally, the Northeast reported the greatest sales increase, with new home sales advancing 14.6 percent to a seasonally adjusted annual rate of 110 thousand units. Sales in the Midwest rose 8.1 percent to an annual rate of 107 thousand units, which was 9.1 faster than the October 1987 annual rate of 98 thousand units. The South was the only region to experience a sales decline, falling 3.9 percent to a seasonally adjusted annual rate of 249 thousand units, but up 1.6 percent from a year ago. In the West, new home sales continued their climb, rising 5.1 percent in October to a seasonally adjusted annual rate of 266 thousand units, which is a 36.4 percent gain over the October 1987 rate of 195 thousand units.

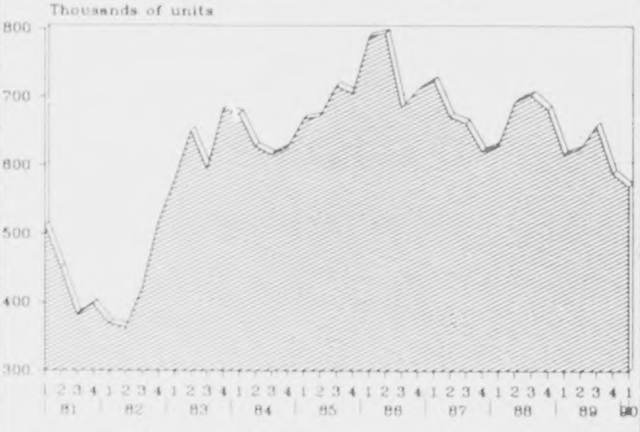
Existing Home Sales

Sales of existing single-family homes rose to a seasonally adjusted annual rate of 3.71 million units in November, 1.1 percent above the October 1988 annual rate of 3.67 million units. Existing single-family home sales rose 10.1 percent above their November 1987 annual rate of 3.37 million units. Contrary to most expectations in the late summer, home sales have been surprisingly strong throughout the fall. Much of this unexpected strength was due to the brief dip in mortgage rates, however, it appears that homebuyers are now trying to keep one step ahead of the even higher interest rates expected in the early part of next year. A slowdown in sales in the very near future is possible if mortgage rates continue to climb above the 11.0 percent mark, and if 1-yr. ARM rates rise with other short-term interest rates. In response to the rising rates, existing home sales could soften to an annual rate of 3.405 million units in the first quarter of 1989, down 7 percent from the 3.63 million unit sales pace of the last quarter of 1988.

Home Prices

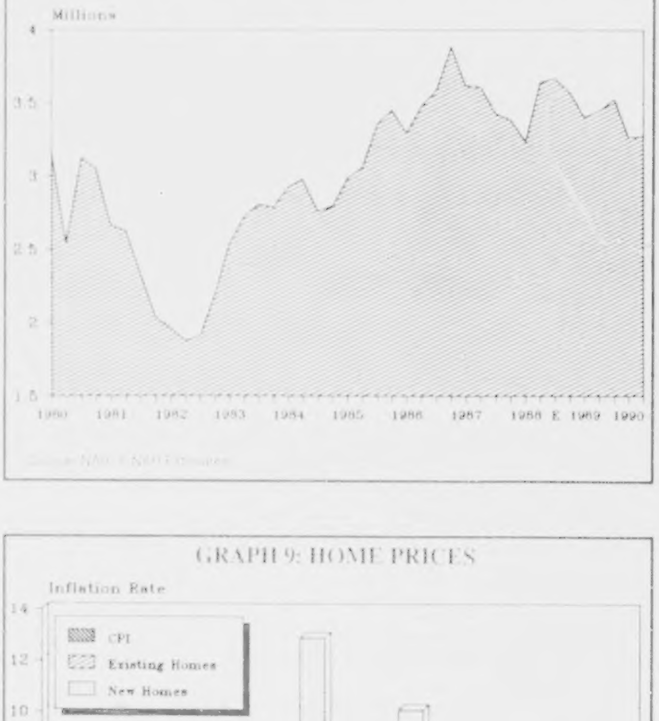
The median sales price of an existing single family home fell slightly in November to $87,900, 0.2 percent below the October median sales price of $88,100, and 3.4 percent above the November 1987 median price of $85,000. Existing single-family home prices have been slipping since August, when the median price peaked at $91,400. In addition, the average price of an existing single-family home has also been on the decline, falling 4.1 percent from its August high of $115,100 to $110,400 in November. As for new homes, the median price fell 1.0 percent in October to $115,900, an 8.8 percent increase over the October 1987 median sales price of $106,500. The average price of a new single-family home was $140,100 in October, down 2.0 percent from August but up 11.4 percent from the October 1987 average price of $125,000.

GRAPH 7: NEW HOME SALES



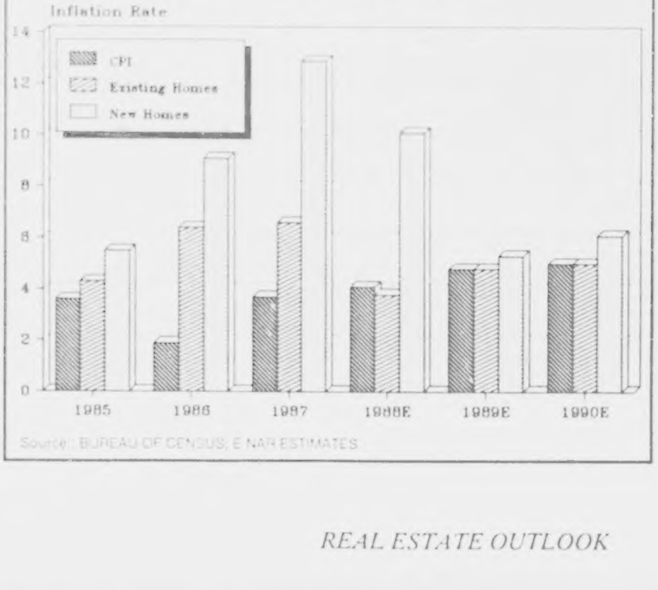
Source: Bureau of Census; E NAR Estimates

GRAPH 8: EXISTING SINGLE-FAMILY HOME SALES



Source: NAR; E NAR Estimates

GRAPH 9: HOME PRICES



Source: BUREAU OF CENSUS; E NAR ESTIMATES

REGIONAL DATA

Housing Starts

The November rise in the national rate of housing starts was brought about by increases in both the South and Northeast. In the Northeast, after being the only region to report a slowdown in October, housing starts sped up by 12.9 percent to a seasonally adjusted annual rate of 228 thousand units. Housing starts rose by 4.8 percent in the South to an annual rate of 612 thousand units, marking the fastest rate since November of last year when homes were started at a rate of 648 thousand units. Following a 14.8 percent increase in October, starts fell 2.2 percent in the West to a seasonally adjusted annual rate of 479 thousand units, 11.1 percent faster than a year ago. In the Midwest, housing starts slowed by 8.3 percent to an annual rate of 244 thousand units, putting starts in the Midwest 22 percent below the rate of November 1987.

Existing Home Sales

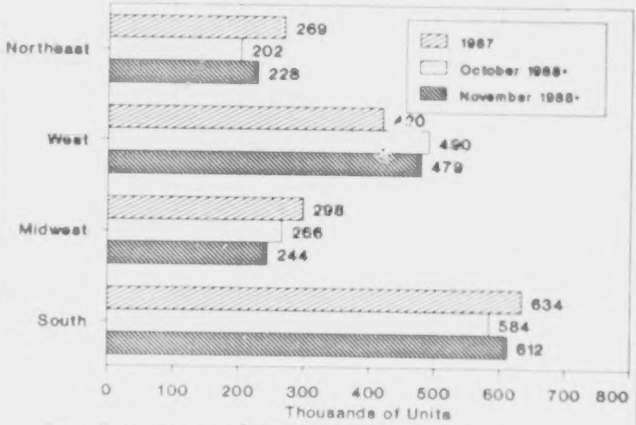
November proved to be a good month for housing activity in the Northeast, as sales of existing single family homes ended their four month decline and jumped 4.6 percent to a seasonally adjusted annual rate of 680 thousand units; putting sales in the Northeast 6.3 percent above the November 1987 annual rate of 640 thousand units. Strong sales were also found in the Midwest, where existing homes were sold at an annual rate of 960 thousand units, 4.3 percent above the October annual rate of 920 thousand units and 7.9 percent above the sales rate of one year ago. In the South, sales were unchanged at 1.4 million units, marking an 11.1 percent increase over November 1987 sales, when homes were sold at an annual rate of 1.26 million units. In the West, for the first time in 1988, sales of existing single-family homes fell for two consecutive months, dropping by 7.0 percent in November to a seasonally adjusted annual rate of 660 thousand units. However sales were considerably stronger than a year ago (up 17.9 percent) when existing homes were sold at an annual rate of 560 thousand units.

Home Prices

The moderate drop in the median sales price of an existing single-family home was shared by all four regions. In the South, the median sales price dipped slightly from the October revised price of $80,500 to $80,300 in November. Prices have been rather flat in the South during the past year, and the November median price was only 1.4 percent higher than the November 1987 median price of $79,200. In the West, the median price dropped 0.4 percent to $122,300, 6.0 percent higher than the median price of one year ago. The median price in the Midwest was $66,700 in November, down 1.0 percent from October but up 3.6 percent from a year ago. In the Northeast, following a 5.0 percent upward revision of the October median sales price to $144,400, the median price dropped 1.3 percent to $142,500, 5.9 percent above the November 1987 price.

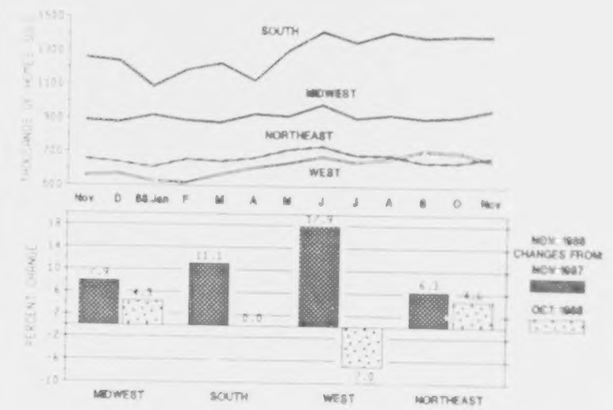
Sean A. Burns, Director of Forecasting
Beth M. Maerz, Research Associate
Forecasting & Policy Analysis Division

GRAPH 10: HOUSING STARTS BY REGION



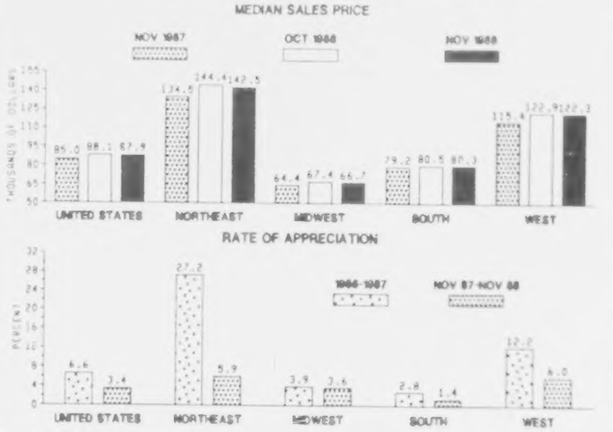
Source: Bureau of Census. *Seasonally adjusted annual rates

GRAPH 11: EXISTING HOME SALES BY REGION



Source: NAR Economics and Research

GRAPH 12: HOME PRICES BY REGION



Source: NAR Economics and Research

U.S. ECONOMIC OUTLOOK

JANUARY 1989

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	88.2	88.3	88.4	89.1	89.2	89.3	89.4	90.1	1986	1987	1988	1989	1990
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4824	4909	5001	5113	5192	5263	5333	5424	4240	4527	4865	5226	5543
% Change	8.7	7.3	7.7	9.3	6.3	5.6	5.4	7.0	5.6	6.8	7.5	7.4	6.1
% Change (w/out inflation)	3.0	2.5	2.3	4.7	2.4	2.1	2.2	2.1	2.8	3.4	3.9	3.0	2.1
Consumer Price Inflation (CPI)	4.8	4.7	4.6	4.8	4.8	4.8	4.8	5.9	1.9	3.7	4.1	4.8	5.0
GNP Inflation (GNP Deflator)	5.5	4.7	5.2	4.5	3.8	3.4	3.1	4.8	2.7	3.3	3.4	4.3	3.9
Unemployment Rate - Civilian	5.4	5.5	5.3	5.4	5.4	5.4	5.3	5.4	7.0	6.2	5.5	5.4	5.5
Civilian Employment-Household Basis (millions)	114.6	115.2	115.9	116.3	116.8	117.3	117.7	118.2	109.6	112.4	115	117	118.7
Percent change	1.5	1.9	2.5	1.3	1.8	1.7	1.6	1.4	2.3	2.6	2.3	1.8	1.4
Index of Industrial Production	136.0	138.4	139.9	141.1	141.8	142.5	143.3	143.7	125.1	129.8	137.2	142.2	144.7
Manufacturing Capacity Utilization	83.2	84	84.4	84.5	84.7	84.6	84.5	84.4	79.7	81	83.6	84.6	84.3
Domestic Auto Sales	7.5	7.6	7.0	7.3	7.0	7.1	7.1	7.0	8.2	7.1	7.4	7.1	6.9
Federal Tax Receipts (NIPA) as % of GNP	20.4	19.9	20.1	20.2	20.3	20.3	20.4	21.0	19.5	20.2	20.1	20.3	21.0
Federal Expenditures (NIPA) as % of GNP	23.1	22.4	22.9	22.8	22.8	22.8	22.8	23.0	24.4	23.7	23.0	22.8	23.0
Deficit(NIPA)	-133.3	-124.8	-143.3	-132.5	-128.2	-129.6	-132.3	-108.5	-205.6	-157.8	-139.1	-130.6	-111.1
as % of GNP	-2.8	-2.5	-2.9	-2.6	-2.5	-2.5	-2.5	-2.0	-4.9	-3.5	-2.9	-2.5	-2.0
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4674	4701	4647	4387	4448	4523	4247	4245	4712	4648	4584	4401	4279
Percent change -- year ago	0.5	-1.8	-4.5	-2.0	-4.8	-3.8	-8.6	-3.2	10.8	-1.4	-1.4	-4.0	-2.8
Existing Single-family Home Sales (thousands)	3643	3670	3570	3405	3450	3527	3268	3276	3565	3526	3539	3413	3307
Percent change -- year ago	0.9	7.0	5.3	4.8	-5.3	-3.9	-8.5	-3.8	10.9	-1.1	0.2	-3.4	-3.1
Housing Starts (thousands)	1481	1465	1508	1388	1410	1408	1384	1376	1512	1634	1482	1397	1383
Percent change -- year ago	-7.8	-3.7	-1.6	-6.0	-4.8	-3.7	-8.2	-0.9	4.1	-9.8	-9.3	-5.7	-1.0
Single-Family Units	1063	1063	1110	1013	1029	1027	1012	999	1183	1157	1083	1020	1002
Percent change -- year ago	-6.5	-7.9	1.9	-7.7	-3.2	-3.4	-9.0	-1.4	10.4	-2.2	-6.4	-5.9	-1.7
Multi-Family Units	419	400	398	375	381	381	374	378	630	477	399	378	381
2-4 Family Units	57.3	58	59.0	55.8	56.6	56.5	55.5	56.1	64.5	65.7	58.0	56.1	56.6
Percent change -- year ago	20.4	7.2	4.8	-1.0	-1.2	-4.7	-6.0	0.5	-9.0	-22.6	-11.8	-3.3	0.8
5 + Family Units	360	347	339	320	325	324	318	322	545	412	341	322	324
Percent change -- year ago	-9.1	-16.9	-12.5	-1.2	-9.9	-4.8	-6.0	0.5	-5.6	-24.4	-17.2	-5.6	0.8
New Single-family Home Sales (thousands)	697	705	683	617	626	660	590	570	750	671	679	623	585
Percent change -- year ago	3.4	4.4	10.0	-2.1	-10.2	-6.4	-13.6	-7.6	9.0	-10.5	1.2	-8.2	-6.1
Mobile Homes Shipped (thousands)	220	216	227	219	222	226	230	228	246	233	219	225	232
HOME PRICES													
Existing Home Prices - Median $(1000)	88.9	90.2	88.5	90.4	92.7	94.7	94.6	95.1	80.3	85.6	88.9	93.1	97.8
Percent change -- year ago	4.5	5.5	4.1	3.0	4.3	5.0	6.9	5.2	6.4	6.6	3.8	4.5	5.0
New Home Prices - Median $(1000)	112.9	115.5	116.5	117.0	119.8	122.6	122.9	123.8	92.0	104.0	114.5	120.5	127.9
Percent change -- year ago	9.1	8.8	4.2	3.6	6.1	6.1	5.5	5.8	9.1	12.9	10.1	5.3	6.1
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.6	10.6	10.6	10.9	11.1	11.0	10.9	10.5	9.9	10.2	10.5	11.0	10.5
1-year ARM (without buydown)	7.6	7.5	7.8	8.1	8.2	8.2	8.1	8.0	7.9	8.2	7.5	8.2	7.6
Corporate AAA Bond Rate	9.8	10.0	9.8	10.3	10.5	10.4	10.3	10.0	9.0	9.4	9.8	10.4	9.9
Government Bond Rate	9.1	9.2	9.1	9.5	9.7	9.6	9.5	9.2	7.8	8.6	9.0	9.6	9.1
Short-Term Interest Rates													
Federal Funds Rate	7.2	8.0	8.4	8.6	8.7	8.6	8.4	8.3	6.8	6.7	7.6	8.6	8.2
3-month T-Bill Rate	6.2	7.0	7.7	7.9	8.0	7.8	7.5	7.4	6.0	5.8	6.7	7.8	7.2
Prime Rate	8.8	9.7	10.2	10.5	10.5	10.3	10.0	10.0	8.3	8.2	9.3	10.3	9.7
Discount Rate	6.0	6.3	6.5	7.0	7.0	6.9	6.5	6.5	6.3	5.7	6.2	6.5	6.7
Value of the U.S. Dollar (Trade-Weighted Avg.)	90.4	97.6	92.3	89.6	88.5	85.5	82.6	81.2	112.3	96.9	92.5	86.5	81.0
Percent change	1.7	35.6	-20.0	-11.0	-4.9	-12.8	-13.1	-6.5	-21.6	-13.6	-4.5	-6.5	-6.4

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz

EQUAL HOUSING
OPPORTUNITY

A7000-1
2/9/89

REAL ESTATE

Vol. 2, No. 2

February 1989

OUTLOOK

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The Department of Commerce reported that real GNP grew 2.0 percent in the fourth quarter of 1988, representing a slight decline from the third quarter growth rate of 2.5 percent.
- The most recent figures on consumer borrowing illustrate the strength in consumer spending during the last quarter of 1988: in November, consumer credit rose $4.48 billion to $657.2 billion (an 8.2 percent annual increase).
- In a recent testimony before the House of Representatives Banking Committee, Federal Reserve Board Chairman, Mr. Alan Greenspan, warned that the amount of economic growth forfeited in the short-term by a tighter monetary policy is far less costly than an extended period of higher inflation.
- Starts of privately owned homes fell 2.2 percent in December to a seasonally adjusted annual rate of 1.524 million units. Although revisions to housing starts estimates are common, the December rate implies that total housing starts in 1988 declined by 8.2 percent to 1.487 million units, the slowest rate of housing construction in the current housing cycle.
- Sales of new, single-family homes fell 8.0 percent in November to a seasonally adjusted annual rate of 671 thousand units, marking the largest one-month decline since May of 1987.
- December sales of existing single-family homes surged to a seasonally adjusted annual rate of 4.09 million units, 11.3 percent faster than the month before and 22.8 percent quicker than a year ago. The December pace is a record for the present housing cycle and is faster than any rate seen since May of 1979.
- Over the course of 1988, the median existing single-family home appreciated 4.1 percent to $89,100 (identical to the 4.1 percent rise in the consumer price index in 1988), compared to $85,600 in 1987.

IN THIS ISSUE

- Economic Commentary: WON'T YOU COME HOME, GEORGE BAILEY,
  by John A. Tuccillo
- Outlook for the Economy and Real Estate, by [illegible]
- Household Mobility and the Perceived Crisis in Homeownership, by [illegible]

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WON'T YOU COME HOME, GEORGE BAILEY

Economic Commentary

by
John A. Tuccillo
Cheif Economist and
Senior Vice President
Real Estate Finance

That's right, George, not Bill, because this commentary is about the movies and how they teach economics. Over the years the silver screen has contained some of the finest gems of economic analysis. But these are yielded only to those who look. Interested in arbitrage? Forget *Wall Street*. Michael Douglas is too transparent, and too far beyond the law to sustain his business. Look rather at George Arliss in *The House of Rothschild* (1934), as he diabolically crushes the evil Count Ledranz by manipulating the British bond market. Worried about OPEC's ability to hold up the price of oil? Go back and look at *Lawrence of Arabia* and sleep peacefully. Think that bank runs are only features of severe economic times? *Mary Poppins* (of all things) will throw a scare into you.

These seemingly idle musings are prompted by the recent holiday season and its endless reruns of *It's a Wonderful Life*, the once special Frank Capra film that has been debased by constant exposure (see, yet another economic lesson!). Most people will view the film as a sentimental statement on friendship, family and the rewards of doing good--a hymn to the dignity and importance of the common man. The economist, however, sees it for what it really is: an analysis of the financial industry in the United States, and the importance of niche marketing. (Actually, until the 75th viewing, these facets are not readily apparent, even to the specialist). Let's look at these ideas in sequence.

The Bailey Building and Loan is no different from any savings and loan as it existed in any American city from the Thirties through the Seventies. It took deposits from the local folk, mostly in small amounts and mostly in an atmosphere that was very personal. Similarly, it used these savings to finance the houses of the very same people in the same personalized manner. And while most savings and loan managers did not necessarily go to the extremes George Bailey did in serving his friends, the close relationship was a hallmark of the industry. Similarly, Mr. Potter's bank was not typical of commercial banks of the era. They were a bit more distant, served a commercial clientele as well as individuals, and had many more ties outside the community than did the building and loan.

But things have changed. And unlike *Jaws*, or *Rocky*, or *Friday the 13th*, Frank Capra did not make *It's a Wonderful Life II*. Did you every wonder (with a nod to Andy Rooney) what happened to George and the Bailey Building and Loan after the movie ended. The odds are that like most of its contemporaries, the association got trapped with those long term low income loans on houses in Bailey Park and was forced to pay ever rising rates to its "friends" who placed their savings there. And George, good-hearted soul that he was, would probably have been unable to cope with a world in which market rates prevailed, competitors moved in on both his depositors and his borrowers, and larger building and loans (not to mention good old Mr. Potter) tried to buy him out.

Lest you think this is a misanthropic treatise, rest assured that the speculations about George's future are based on what in fact has happened in the savings and loan industry. A great deal of the current thrift mess stems from the fact that the industry, and its managers, grew up in a world that simply disappeared, leaving them ill-equipped to deal with the one that replaced it (c.f. *The Land Before Time*). In the new world, far fewer institutions are necessary. In other words, if there had never been any fraud in the industry, if oil prices had never fallen from $35 a barrel, and if interest rates had never soared to 20 percent, George Bailey might have still become only a fond memory, Clarence or no.

But, George did survive in his world, and there's a lesson in that. He had attained a market niche. Never big enough to challenge Mr. Potter, the Bailey Building and Loan had "size equivalence," the ability to command a market share because of character. Personal service enabled George to be a community and market force, and successfully compete against Potter. For real estate firms, the example should not be lost. Some firms are large enough to control a significant share of their market. Others achieve this size by proxy through participation in a franchise arrangement. Still others have neither size nor quality, but have a sharply-etched identity that preserves for them a viable market share.

Just as the world changed for George Bailey, it is also evolving for the real estate industry. As with so many aspects of American business, real estate is moving through the age of the "vanishing middle." Firms that have neither absolute size nor readily-identifiable "boutique" identity are disappearing in favor of those who do. In the late-Nineties, the aging of the baby boom generation will put a downward sign on the real estate business. Then, the achievement of size equivalency will be an imperative.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

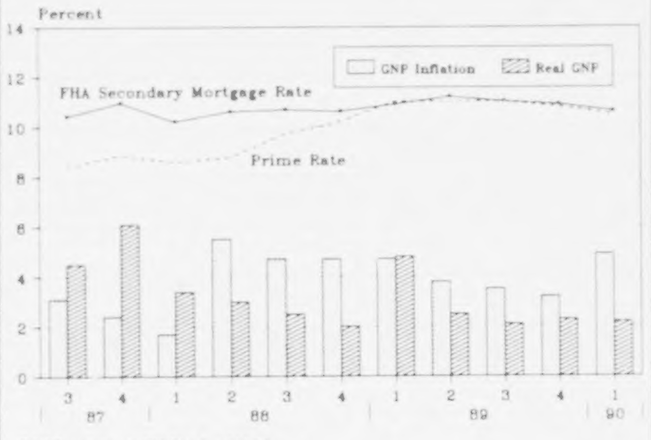
The Department of Commerce recently reported that the preliminary estimate of real GNP growth in the fourth quarter of 1988 was 2.0 percent, representing a slight decline from the third quarter growth rate of 2.5 percent. In advance of this release, indicators of the economy's health had suggested that the export-led expansion of early 1988 was beginning to falter. The fourth quarter GNP report confirms this trend, as real net exports declined for the second consecutive quarter. In its place, increased consumption due to strong employment growth and high consumer confidence, along with surprisingly buoyant housing construction activity has helped the rate of real GNP growth reach 3.8 percent during 1988. Consequently, the monetary authority has continued to tighten monetary policy in an effort to avert a significant rise in the rate of inflation. The Fed has indicated that it is prepared to reel in credit even more should conditions warrant. The 2.0 percent growth rate of the fourth quarter is a welcome positive sign that could temporarily lessen fears of a rapidly accelerating rate of inflation.

Financing Consumption the American Way

The most recent figures on consumer borrowing illustrate the strength in consumer spending during the last quarter of 1988: in November, consumer credit rose $4.48 billion to $657.2 billion (an 8.2 percent annual increase). The expectation had generally been that consumption would slow in 1988, leading to a higher rate of saving, and reducing the risk of faster inflation. While consumer prices rose only modestly (4.1 percent in 1988), spending has shown few signs of retreat; and it is borrowing, rather than saving, that has continued to grow. Revolving credit (borrowing on bank credit cards, personal bank loans, and retail and gasoline credit) has led the growth in consumer credit. And while many argue that the figures on revolving credit overstate the level of borrowing by including credit that is paid off before finance charges set in, this does not explain its rise from 2.4 percent of income in 1977 to 5.2 percent in 1988. Looking ahead to 1989, consumption could ease if consumers begin to steadfastly pay down some of this debt as the deductibility of interest on this debt is virtually phased out.

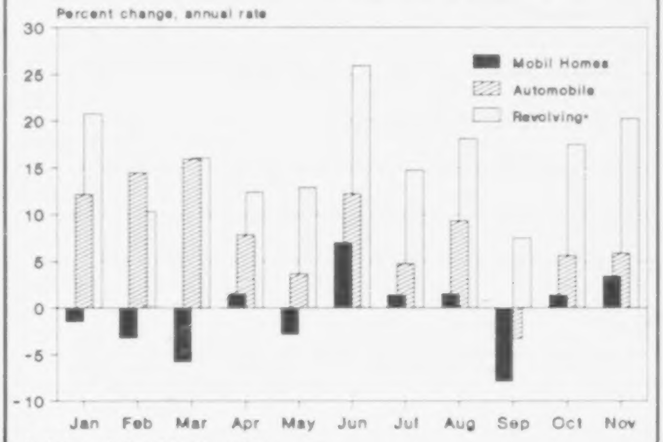
Partly as a result, consumer loans are increasingly being replaced by home equity loans, which remain fully deductible, and typically carry a lower interest rate (due to the reduced risk of a secured loan). The flexible and still relatively new home equity credit lines are being used to pay off automobile, credit card, and personal bank loan balances, according to a recent survey by the Survey Research Center at the University of Michigan. In addition, the equity credit lines have been used to make new outlays that have been historically financed through consumer loans, i.e. automobile and personal loans. Presently, home equity lines of credit appear to be a vehicle of the wealthy (median income of $58,700) and concentrated in the Northeast. However, their use has spread rapidly since their introduction and will continue to do so as knowledge of their application increases as well.

GRAPH 1: THE ECONOMIC OUTLOOK



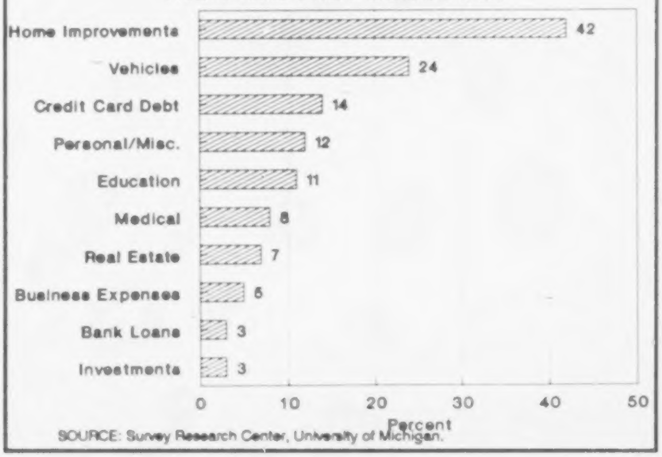
E NAR estimates(1988:IV thru 1989:IV)

GRAPH 2: CONSUMER CREDIT GROWS



•Includes retail and bank-card borrowing
SOURCE: The Federal Reserve Board.

GRAPH 3: HOME EQUITY CREDIT LINES: WHAT ARE THEY GOOD FOR?



SOURCE: Survey Research Center, University of Michigan.

Monetary Policy and Interest Rates

Federal Reserve Board Chairman, Mr. Alan Greenspan, reconfirmed his commitment to battle inflation in recent testimony before Congress. In defense of his anti-inflationary policy, Mr. Greenspan cautioned that the amount of economic growth forfeited in the short-term by a tighter monetary policy is far less costly than an extended period of higher inflation. Of course, the current policy of tighter credit and higher interest rates is not without its own risks. During the past month, Mr. Greenspan and his fellow central bankers around the world have employed their foreign exchange reserves in an effort to stall a steady rise in the dollar brought about by these higher U.S. interest rates. A stronger dollar could interrupt improvement in the U.S. trade deficit, which has already shown signs of pausing at the end of 1988.

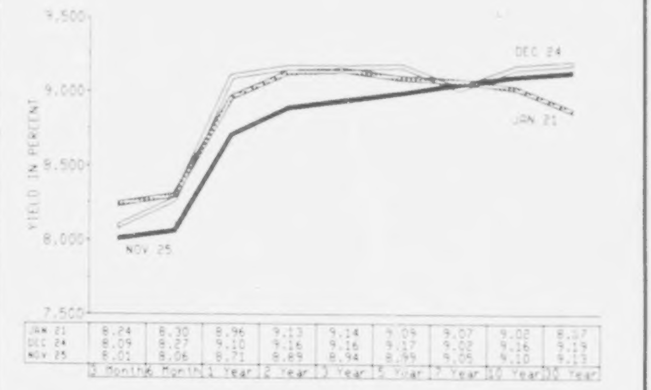
Housing Starts

Starts of privately owned homes fell 2.2 percent in December to a seasonally adjusted annual rate of 1.524 million units. Although revisions to housing starts estimates are common, the December rate implies that total housing starts in 1988 declined by 8.2 percent to 1.487 million units, the slowest rate of housing construction in the current housing cycle. Single-family starts dipped 1.9 percent in December to a seasonally adjusted annual rate of 1.114 million units. In 1988, single-family starts totalled 1.08 million units, a drop of 5.8 percent from the 1.146 million units of 1987. Starts of structures with 2 to 4 units totalled 59.2 thousand units in 1988, a decline of 9.9 percent from the 1987 total of 65.7 million units. Housing starts of structures with 5 or more units fell 2.6 percent in December to an annual rate of 344 thousand units. In 1988, starts of these structures dropped 14.9 percent to a total of 347.8 thousand units. It appears that the 1986 tax laws, which curtailed many incentives in the tax code to own rental property, continues to squeeze the multi-family market. However, much of the adjustment to the tax code change occurred in 1987 when multi-family starts fell 24.4 percent. The rate of total housing starts activity is expected to continue easing this year, falling an estimated 6.6 percent in 1989 to 1.385 million units. However, the pace of single-family starts will likely remain at the robust rate of one million units.

New Home Sales

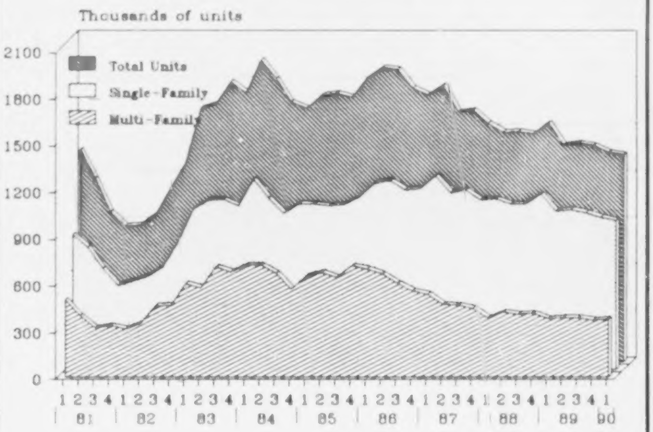
Sales of new, single-family homes fell 8.0 percent in November to a seasonally adjusted annual rate of 671 thousand units, marking the largest one-month decline since May of 1987. The disappointing performance in November came at the end of a year characterized by considerably strong sales. In the wake of the October 1987 stock market crash, new home sales were expected to decline by at least 2 to 4 percent in 1988. However, surprisingly vigorous economic growth propelled by an export expansion and the resilient American consumer pushed new home sales to an estimated 679 thousand units, 1.3 percent above the 1987 total of 671 thousand units. In 1989, new home sales are expected to slow by about 8 percent to an estimated 623 thousand units due to higher interest rates in the first quarter and generally slower economic growth throughout the year.

GRAPH 4: THE YIELD CURVE



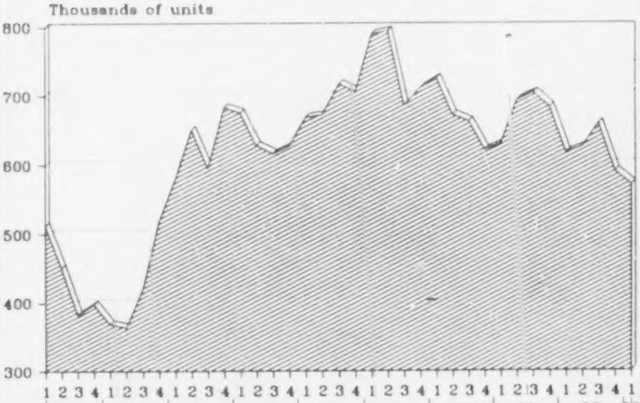
SOURCE: The Federal Reserve Board, E NAR Estimates.

GRAPH 5: HOUSING STARTS



SOURCE: The Bureau of Census, E NAR Estimates.

GRAPH 6: NEW HOME SALES



SOURCE: Bureau of Census; E NAR Estimates.

Existing Home Sales

December sales of existing single-family homes surged to a seasonally adjusted annual rate of 4.09 million units, 11.3 percent faster than the month before and 22.8 percent quicker than a year ago. The December pace is a record for the present housing cycle and is faster than any rate seen since May of 1979. The huge jump in existing home sales seemed to be the result of two unrelated occurrences. First, existing home sales in the South shot up 15.8 percent from November to December. Apparently, relatively lower housing prices characteristic of the soft housing market in much of that region has begun to re-attract homeowners and investors. Second, a more restrictive monetary policy of late has caused short-term interest rates to rise by as much as 250 basis points in recent months. As a result, rates on adjustable rate mortgages have begun to reflect a small portion of this general rate rise. Potential homebuyers, specifically those who have been counting on an adjustable rate mortgage in order to qualify for a loan, seem to have moved forward their home buying decisions over concern that these rate increases would delay a planned home purchase. The Federal Home Loan Bank Board reported that adjustable rate mortgages accounted for a 64 percent share of total mortgages issued on existing homes in December, the highest share since January of 1988.

Home Prices

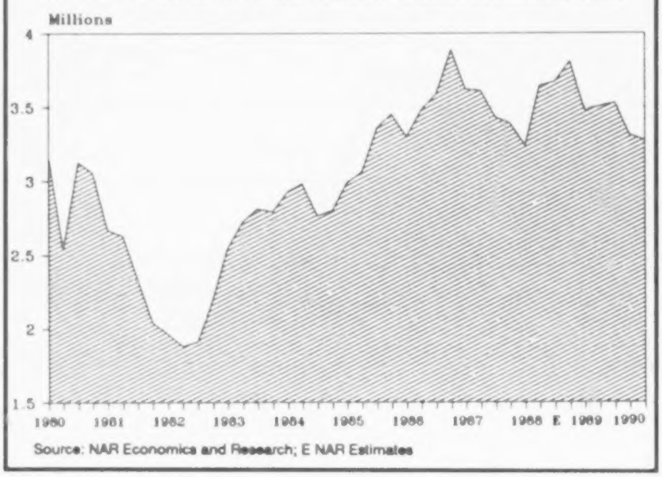
The median price of an existing single-family home dropped for the fourth consecutive month, falling 0.3 percent in December to $87,700. The December price was 2.7 percent above the $85,400 median price of December 1987, but 4.1 percent below the 1988 peak of $91,400, set in August. Over the course of 1988, the median existing single-family home appreciated 4.1 percent to $89,100 (identical to the 4.1 percent rise in the consumer price index in 1988), compared to $85,600 in 1987.

REGIONAL DATA

New Home Sales

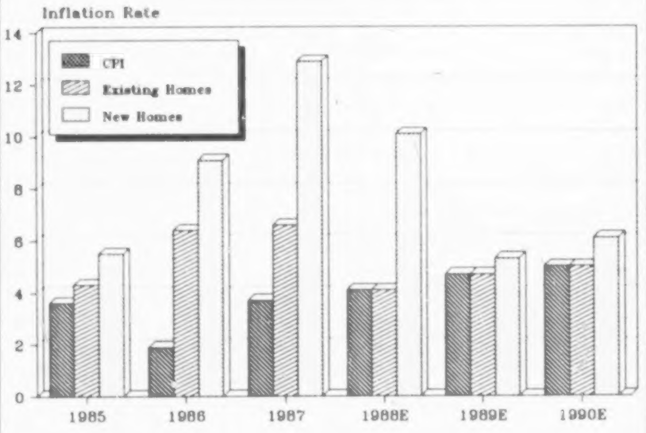
The decline in new home sales during November fell disproportionately on the Northeast, where sales declined 27 percent to a seasonally adjusted annual rate of 72 thousand units, 53 percent lower than the November 1987 annul rate of 154 thousand units, and marking the lowest rate in 55 months. In addition, the sales rates in both September and October were revised downward 9.0 percent and 11.0 percent, respectively. Sales fell 7.6 percent in the South to a seasonally adjusted annual rate of 245 thousand units, which marked the slowest rate since the 204 thousand unit rate set in January of 1988. In the West, sales dropped 6.8 percent to an annual rate of 233 thousand units, but were 32.4 percent stronger than the year ago pace of 176 thousand units. The Midwest was the only region to experience a rise in the rate of new home sales. November sales increased 5.2 percent to an annual rate of 121 thousand units, or 36.0 percent faster than the 99 thousand unit annual rate of one year ago and a sixteen month high for sales in the Midwest.

GRAPH 7: EXISTING SINGLE-FAMILY HOME SALES



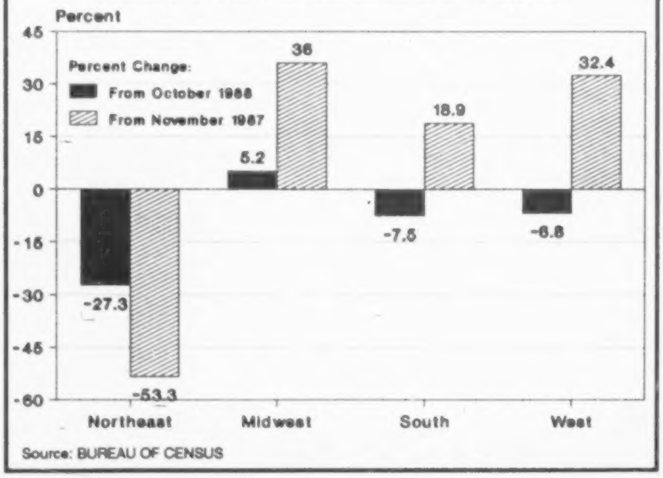
Source: NAR Economics and Research; E NAR Estimates

GRAPH 8: HOME PRICES



Source: NAR; E NAR Estimates.

GRAPH 9: NEW HOME SALES BY REGION



Source: BUREAU OF CENSUS

Housing Starts

December housing starts fell in every region except the Midwest, where starts rose 25.1 percent to an annual rate of 329 thousand units. In percentage terms, housing construction activity slowed the most in the Northeast where starts fell 20.9 percent to a seasonally adjusted annual rate of 179 thousand units, the slowest pace since March of 1984. In the West, homes were started at an annual rate of 427 thousand units, 7.2 percent below the 460 thousand unit rate set in November. In the South, housing starts fell 3.6 percent to a seasonally adjusted annual rate of 589 thousand units. All four regions experienced a decline in starts from 1987 to 1988 The largest slowdown occurred in the Northeast where starts fell 12.5 percent to a total of 235.3 thousand units. In the South, housing starts reached 574.7 thousand units, down 9.3 percent from the 1987 total of 633.9 thousand units. In the Midwest, construction began on 272.6 thousand units compared to 297.9 units in 1987 (an 8.4 percent decline). The West maintained the strongest housing activity during 1988 and experienced the smallest decline (3.6 percent), with a total of 404.5 thousand units.

Existing Home Sales

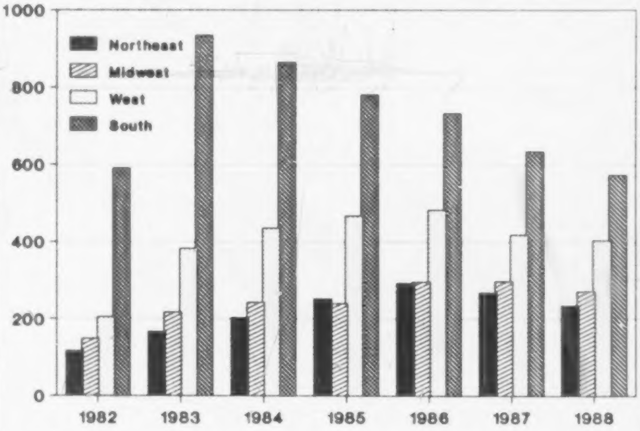
All four regions enjoyed a healthy rate of existing single-family home sales in the last month of 1988, with sales in the South recording the largest advance of 15.8 percent. The 1.61 million unit rate in the South was 29.8 percent above the rate of sales one year ago and the highest sales pace in the current housing cycle. In the South, 1.351 million existing single-family homes were sold during 1988, an increase of 5.4 percent over 1987. As mentioned before, the increased activity in the South appears to be the result of a process of clearing the excess inventory of existing homes for sale in much of that region. In the other regions, the sales pace rose 10.4 percent from November to December in the Midwest to a seasonally adjusted annual rate of 1.06 million units, also a current housing cycle high. Sales totalled 935 thousand units in 1988, a 2.5 percent decline from 1987. In the West, existing homes were sold at an annual rate of 690 thousand units in December (4.5 percent above the November annual rate) and totalled 645 thousand homes in 1988 (a 7.5 percent increase from 1987). In the Northeast, existing home sales grew by 4.4 percent to a 710 thousand unit rate for December. The 1988 total for the Northeast region was 2.5 percent below the 1987 total of 681 thousand units

Home Prices

A substantial inventory of lower priced homes being sold in parts of the South resulted in a 2.2 percent decline in the median home price to $78,500. The median price fell 8.6 percent in the West to $117,800, while prices rose in the Midwest (0.1 percent to $67,800) and the Northeast (1.8 percent to $143,300). In terms of annual appreciation, prices in the West rose the fastest, increasing 9.2 percent to $123,700 in 1988, compared to a 7.4 percent rise in the Northeast to $143,100, 3.5 percent rise in the Midwest to $68,300 and a 2.4 percent jump in the South to $82,300.

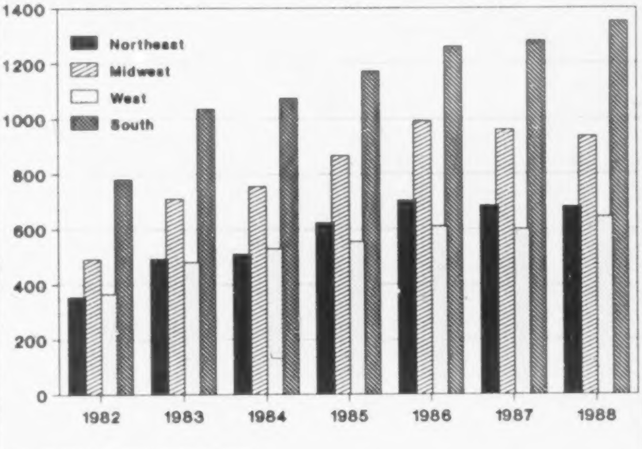
Sean A. Burns, Director of Forecasting
Beth M. Maerz, Research Associate
Forecasting and Policy Analysis Division

GRAPH 10: HOUSING STARTS BY REGION



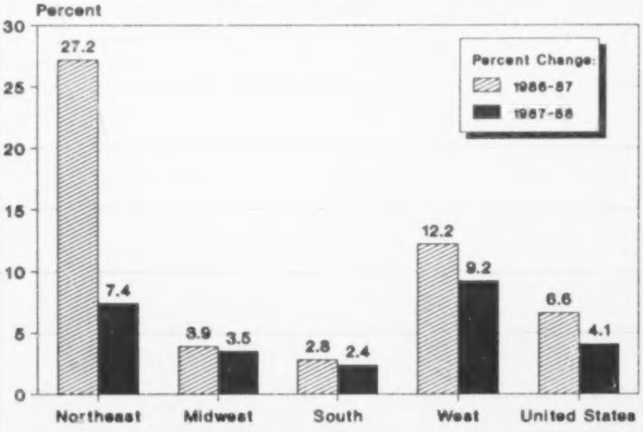
Source: Bureau of Census.

GRAPH 11: EXISTING HOME SALES BY REGION



Source: NAR Economics and Research.

GRAPH 12: HOME PRICES BY REGION



Source: NAR Economics and Research.

HOUSEHOLD MOBILITY AND THE PERCEIVED CRISIS IN HOMEOWNERSHIP

During the 1980s the proportion of households owning homes in the United States declined from 43 percent to 36 percent for the 25 - 29 age group and from 61 percent to 53 percent for the 30 - 34 age group. The median age for first-time homebuyers increased by over five years (from 26.0 to 31.5) during the decade from 1977 to 1987. The affordability index value for first-time homebuyers is currently some 30 points lower than for all homebuyers (79.3 vs. 114.1). The litany is familiar--all available indicators seem to confirm the widely held notion that a homeownership crisis currently afflicts prospective first-time homebuyers.

What remains unclear is precisely why a crisis exists. Is it primarily a financing problem, e.g., owing to prohibitively high downpayment requirements or to unmanageably high monthly principal and interest payments? Is it primarily a demographic problem, e.g., owing to growing numbers of single-person and other non-traditional households for whom rental units are typically more suitable than are owner-occupied units? Or is the crisis due to some combination of these factors and, perhaps, to other as-yet-unidentified factors?

THE NATIONAL ASSOCIATION OF REALTORS® National Homeownership Survey conducted in 1986 provides a unique opportunity to look for likely causes of the perceived homeownership crisis. Specifically, this survey permits comparison of "prospective homeowners" with "marginal homeowners." Prospective homeowners are defined as all current renters who moved into their dwelling units within the preceding five years, who did not own their previous homes, and who gave "serious thought" to owning at the time of their move. Marginal homeowners include all current owners who purchased their homes within the preceding five years but who gave "serious thought" to renting at the time of their move.

Differences between those two groups may provide insight into why some households have managed to become homeowners, albeit often with difficulty, while so many others remain renters in spite of their expressed desire to own. The following table compares selected household characteristics for prospective homeowners with those of marginal homeowners. Asterisks indicate characteristics having a statisitically significantly difference between the two groups.

COMPARATIVE HOUSEHOLD CHARACTERISTICS FOR PROSPECTIVE HOMEOWNERS AND MARGINAL HOMEOWNERS

Household Characteristics	Prospective Homeowners	Marginal Homeowners
Married Houshold	42.1%	45.7%
Ageof Household Head (avg. yrs.)*	35.1	42.3
Household Size (avg. no.)*	2.8	2.4
Household Income Earners (avg. no.)	1.6	1.5
Household Current Income (1984)*	$20,615	$24,405
Household Saving Rate As Percent of Income (previous 5 yrs.)	3.4%	4.4%
Expect to Move in Next 10 Years*	90.2%	64.8%
Expect Household Size Increase in Next 5 Years	22.1%	13.3%

* Indicates characteristic values differ at .05 level of significance.

Not surprisingly, prospective homeowners were found to have significantly lower incomes (18% lower on average) and lower savings rates (3.3% vs. 4.3%) than did marginal homeowners. This is certainly consistent with the generally held view that lack of affordability prevents many households from becoming homeowners.

But the characteristic which most sets prospective homeowners apart from marginal homeowners is their much higher expectation of moving. Whereas fewer than two-thirds of marginal homeowners expected to move within the next ten years, more than nine out of ten prospective homeowners expected to move. And this difference in expected mobility remains both sizeable and significant between the two groups of households regardless of their age, income, or previous tenure.

This finding raises further questions, particularly regarding *why* prospective homeowners have such high expectations of moving and *how* expectations of moving affect a household's rent/buy decision. Although answering these questions will entail a great deal more research and data analysis than have been done to date, some heuristic evidence and conjectural explanations present themselves here.

Costs associated with buying and selling a home obviously constitute an obstacle to homeownership. Presumably, the shorter the length of time a household expects to live in its house the higher the expected annual prorated costs of buying and selling that house. The implication is that the focus of future public policy as well as a concern of today's real estate agent ought to be on closing and other transactions costs of homeownership. (As an article in the December issue of *Real Estate Outlook* indicated, even the process of obtaining home finance information may itself represent a sizeable "transaction cost" for some prospective homeowners.)

An estimated 18.0 percent of the U.S. population lived in a different house in 1986 than they did in 1985; this is a sizeable increase from the 16.6 percent of the population which moved between 1981 and 1982.[1] Current mobility rates may be unusually high because of recent demographic trends. In particular, swollen by post-World War II baby-boomers, young households now comprise a disproportionately large share of all U.S. households.

Whether household mobility will increase or decrease in the foreseeable future depends largely on which of two projected demographic trends will predominate. On the one hand, as the baby-boomer generation ages, their mobility is likely to diminish if they behave as older households typically do. Whereas the mobility rate for households in the 25 - 29 age class was 32.8 percent in 1986, only 22.5 percent of households in the 30 - 34 age class and 15.7 percent of those aged 35 - 44 moved in that year.[2]

On the other hand, single-person households are projected to increase from the current 24 percent of total households to 32 percent by the year 2000. Average household size is also projected to decline from 2.7 to 2.5 members during that period.[3] These trends would seem conducive to increased rather than to decreased mobility.

Under the "confirming what everyone knows" rubric is our finding that homeownership overwhelmingly remains the American dream. Across all income and age classes, 95 percent or more of the households we define as prospective homeowners said they would like to own their own homes. Even among renter households which had not recently given serious thought to owning, four out of five said they would like to own.

In sum, although much remains to be learned about the rent/buy decision, convincing evidence exists that realization of their homeownership dream is somehow being either delayed or prevented by many households' high expectation of moving. Whether household mobility is likely to increase or to decrease on balance over the next decade will depend upon the opposing influences of aging baby-boomers and single-person households.

by
John Simonson
Professor of Economics
University of Wisconsin-Platteville
Visting Scholar at the
NATIONAL ASSOCIATION OF REALTORS®

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[1] U.S.Bureau of the Census, *Current Population Reports*, Series p-20, No. 393.

[2] U.S.Bureau of the Census, *Current Population Reports*, Series p-20, No. 393.

[3] Peter Morrison, "Demographic Factors Shaping the U.S. Market for New Housing," A Rand Corporation Report as cited in Sam Hankin, "Two-Income Households Expected to Boost Homeownership Rates," *The Washington Post* (January 14, 1989), p. F-4.

U.S. ECONOMIC OUTLOOK FEBRUARY 1989

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	88.2	88.3	88.4	89.1	89.2	89.3	89.4	90.1	1986	1987	1988	1989	1990
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4824	4909	4990	5109	5188	5259	5332	5426	4240	4527	4862	5222	5556
% Change	8.7	7.3	6.8	9.7	6.4	5.6	5.6	7.2	5.6	6.8	7.4	7.4	6.4
% Change (w/out inflation)	3.0	2.5	2.0	4.8	2.5	2.1	2.3	2.2	2.8	3.4	3.8	2.9	2.3
Consumer Price Inflation (CPI)	4.8	4.7	4.3	5.0	5.1	4.9	4.9	5.7	1.9	3.7	4.1	4.7	5.0
GNP Inflation (GNP Deflator)	5.5	4.7	4.7	4.7	3.8	3.5	3.2	4.9	2.7	3.3	3.4	4.4	4.0
Unemployment Rate - Civilian	5.4	5.5	5.3	5.4	5.4	5.4	5.3	5.3	7.0	6.2	5.5	5.4	5.3
Civilian Employment-Household Basis (millions)	114.6	115.2	115.9	116.3	116.8	117.3	117.8	118.2	109.6	112.4	115.0	117.0	118.9
Percent change	1.5	1.9	2.5	1.3	1.8	1.7	1.7	1.5	2.3	2.6	2.3	1.8	1.6
Index of Industrial Production	136.0	138.4	140.1	141.4	142.2	142.9	143.7	144.2	125.1	129.8	137.2	142.6	145.5
Manufacturing Capacity Utilization	83.2	84.0	84.6	84.7	85.0	84.9	84.8	84.7	79.7	81.0	83.6	84.8	84.8
Domestic Auto Sales	7.5	7.6	7.0	7.3	7.1	7.2	7.2	7.1	8.2	7.1	7.4	7.2	7.0
Federal Tax Receipts (NIPA) as % of GNP	20.4	19.9	20.1	20.2	20.3	20.3	20.4	21.0	19.5	20.2	20.1	20.3	21.0
Federal Expenditures (NIPA) as % of GNP	23.1	22.4	22.5	22.8	22.8	22.8	22.8	22.9	24.4	23.7	22.9	22.8	22.9
Deficit(NIPA)	-133.3	-123.5	-134.2	-139.8	-134.1	-134.5	-134.7	-108.3	-205.6	-157.8	-136.5	-135.8	-105.5
as % of GNP	-2.8	-2.5	-2.9	-2.6	-2.5	-2.5	-2.5	-2.0	-4.9	-3.5	-2.9	-2.5	-2.0
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4674	4702	4904	4462	4501	4506	4260	4205	4712	4648	4644	4432	4259
Percent change – year ago	-0.5	3.8	10.3	-2.0	-3.7	-4.2	-13.1	-5.8	10.8	-1.4	-0.1	-4.6	-3.9
Existing Single-family Home Sales (thousands)	3643	3670	3810	3475	3505	3527	3310	3276	3565	3526	3593	3454	3307
Percent change – year ago	0.9	7.0	12.4	6.9	-3.8	-3.9	-13.1	-5.7	10.9	-1.1	1.9	-3.9	-4.3
Housing Starts (thousands)	1481	1468	1538	1395	1408	1392	1346	1331	1812	1634	1483	1385	1359
Percent change – year ago	-7.8	-9.3	0.3	-5.6	-4.9	-5.2	-12.5	-4.5	4.1	-9.8	-9.2	-6.6	-1.9
Single-Family Units	1063	1064	1128	1018	1027	1009	979	958	1183	1157	1083	1008	981
Percent change – year ago	-6.5	-7.8	-0.1	-7.2	-3.4	-5.1	-13.2	-5.9	10.4	-2.2	-6.3	-6.9	-2.7
Multi-Family Units	418	405	410	377	382	382	367	374	630	477	400	377	378
2-4 Family Units	57	58	66	54	54	55	52	53	85	66	57	54	54
Percent change – year ago	-20.4	4.2	14.6	-4.6	-5.2	-5.5	-20.8	-0.8	-9.0	-22.6	-13.3	-5.7	0.2
5 + Family Units	360	347	344	323	327	328	315	321	545	412	343	323	324
Percent change – year ago	-9.1	-15.2	-0.7	-0.1	-9.2	-5.5	-8.5	-0.8	-5.6	-24.4	-16.7	-5.7	0.2
New Single-family Home Sales (thousands)	697	705	683	617	626	660	590	570	750	671	679	623	585
Percent change – year ago	3.4	4.4	10.0	-2.1	-10.2	-6.4	-13.6	-7.6	9.0	-10.5	1.2	-8.2	-6.1
Mobile Homes Shipped (thousands)	219.7	219.0	229.6	219.6	224.2	227.2	230.4	231.4	245.5	232.8	218.7	225.4	235.1
HOME PRICES													
Existing Home Prices - Median $(1000)	88.9	90.2	87.9	88.5	91.9	93.7	94.8	95.1	80.3	85.6	89.7	93.3	97.9
Percent change – year ago	4.5	5.5	3.4	0.8	3.4	3.9	7.8	7.5	6.4	6.6	4.1	4.7	5.0
New Home Prices - Median $(1000)	112.9	115.5	116.5	117.0	119.8	122.6	122.9	123.8	92.0	104.0	114.5	120.6	127.9
Percent change – year ago	9.1	8.8	4.2	3.6	6.1	6.1	5.5	5.8	9.1	12.9	10.1	5.3	6.1
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.6	10.6	10.6	10.9	11.2	11.0	10.9	10.6	9.9	10.2	10.5	11.0	10.5
1-year ARM	8.3	8.5	8.7	8.8	8.8	8.5	8.2	8.2	9.5	8.5	8.5	8.6	8.2
Corporate AAA Bond Rate	9.8	10.0	9.8	10.1	10.3	10.2	10.0	9.8	9.0	9.4	9.8	10.2	9.7
Government Bond Rate	9.1	9.2	9.1	9.4	9.6	9.5	9.4	9.1	7.8	8.6	9.0	9.5	9.1
Short-Term Interest Rates													
Federal Funds Rate	7.2	8.0	8.4	9.0	9.3	9.1	8.6	8.3	6.8	6.7	7.6	9.0	8.2
3-month T-Bill Rate	6.2	7.0	7.7	8.3	8.4	8.2	8.0	7.7	6.0	5.8	6.7	8.2	7.5
Prime Rate	8.8	9.7	10.2	11.0	11.0	11.0	10.8	10.5	8.3	8.2	9.3	11.0	9.7
Discount Rate	6	6.3	6.5	7.0	7.0	6.9	6.5	6.5	6.3	5.7	6.2	6.5	6.5
Value of the U.S. Dollar (Trade-Weighted Avg.)	90.4	97.6	92.4	89.0	87.2	84.4	81.9	81	112.3	96.9	92.6	85.6	81
Percent change	1.7	35.6	-19.5	-14.0	-8.0	-12.1	-11.2	-4.6	-21.6	-13.6	-4.5	-7.5	-5.4

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz.

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

REAL ESTATE OUTLOOK

Vol. 2, No. 3

March 1989

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- Recent indicators of the economy's health suggest that, at present, this economic expansion is still going strong. Reports on economic activity in the opening month of 1989 included substantial increases in employment, retail sales, housing starts and industrial production.
- While indicators point towards continued economic growth, the chances for a steady rise in the rate of inflation are also growing. Prices at the wholesale level rose 12.7 percent at an annual rate in January, accompanied by a 7.2 percent increase in the consumer price index, taken at an annual rate.
- Financial markets looked to the Federal Reserve for reassurance on its own commitment to control inflation. In response, the Fed forced the federal funds rate up by almost 3/4 of a percentage point to 9.75 percent and raised the discount rate to 7 percent from 6.5 percent.
- Housing starts jumped 8 percent in January to a seasonally adjusted annual rate of 1.693 million units, the fastest rate since March of 1987. Single-family starts climbed 7.1 percent to a seasonally adjusted annual rate of 1.203 million units, while multi-family starts were up 10.1 percent to a seasonally adjusted annual rate of 490 thousand units.
- Sales of new single-family homes reached an annual rate of 669 thousand units in December, up slightly from the November rate of 665 thousand units, and 14.2 percent faster than the 586 thousand unit pace of one year ago.
- Sales of existing single-family homes took a breather in January, slowing to a seasonally adjusted annual rate of 3.63 million units, or 7.4 percent below the December annual rate of 3.92 million units.
- The January median existing single-family home price rose to $91,500, a 3.6 percent increase from the December median price of $88,700. However, even with this sizable monthly increase, the January median price was just 3.9 percent above January 1988, reflecting the modest increase in home prices during 1988.

IN THIS ISSUE

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THE SPRING OF OUR DISCONTENT

Economic Commentary

by
John A. Tuccillo
Chief Economist and
Senior Vice President
Real Estate Finance

March is a wonderful month. In many--if not most--parts of the country the grip of winter gives way to the gentler caress of warmer weather. In Florida and California, Spring is officially ushered in by the crack of bat and the thud of ball on glove. Most of all, the entire month is given over to that greatest of all sporting events, the NCAA basketball tournament. In the words of the commercial, "It doesn't get any better than this."

Unless, of course, you operate in a business that is affected by interest rate movements. In this particular Spring, the warmest weather will be in financial markets where the Federal Reserve is steadily pushing interest rates upward in its crusade to keep the inflation dragon in its cave. It seems that for most of the fall, and into the winter, Chairman Greenspan has been using his bully pulpit to preach of the evils of inflation and how those evils are looming ever larger in this growing economy. And he was right. But like the prophet in his own country, his message was not given nearly the weight it deserved.

Now, however, the voice is coming through loud and clear. Two prime rate increases and one discount rate rise in the course of two weeks have hit the economy upside the head and banged in the old-time religion. The result is that the recent increases in interest rates will continue through most of the Spring, and will have a retarding effect on what is an otherwise strong housing market.

Three questions need to be asked. First of all, are the Fed's recent actions justified? Like all good economic questions, this one can be answered yes and no. It now appears that the economy was expanding much too rapidly at the end of 1988. In the seventh year of an expansion, with our low rates of savings and investment and the pressures on plant and equipment that have been building up, increased inflation was almost inevitable. January's price figures, although biased by the drought of last summer, verified this. But like the generals who fight the last war, the Federal Reserve Board's actions may be a bit late. Financial markets realized the danger of increased inflation at least six weeks before the increase in the discount rate, and acted to slow the economy on their own. Thus, the Fed's action has the effect of punctuating the sentence rather than being its predicate.

The second question deals with the appropriateness of the Fed's policy in general. Specifically, is the Fed inexorably pushing this economy into recession? The answer here is no. While it has been restrictive in its policy stance, the Fed has acted slowly and incrementally. It has done nothing in such large measure that it cannot pull back. Our view of the economy is that the Fed will have realized that it was successful by May of this year, and will begin to pull back, thus easing interest rates. There is no recession in the cards for 1989, although, we will see the growth rate drop into the 2.5 percent area.

The final question deals with the housing sector. Will this rate rise kill off the 1989 market? It's inevitable that the rise in interest rate will push some buyers out of the market. But there really is a tug of war going on here. The demographics of housing right now are extraordinary. In most parts of the country, the number of customers in the market is quite pleasant. But pulling against that demand will be the interest rate hit to affordability. This arrangement is far from unusual--in fact, a market in which the struggle does not take place is the exception.

In 1988, the demographics won, and resales reached their highest point of the eighties. For 1989, we're looking (at least in the first half of the year) for at best a stalemate. The numbers we will see for resales will be strong, but not nearly what they were in 1988. January's home sales numbers illustrate the nature of this year. The national totals were down more than seven percent from December's pace, but are up more than thirteen percent from January 1988. As the year progresses, we will see more month to month declines, but smaller margins over last year's pace. Finally, and quite paradoxically, the home sales figures for the second half of the year, after interest rates have stabilized, will be up from the first half of the year, but below 1988.

For most REALTORS®, all this sums up to a case of lost potential. When all is said and done, 1989 will be an OK year. The shame of it all is that but for the interest rate rise that we are now living through, it could have been an outstanding one. But, this is the seventh year of the housing expansion, and aging robs many of us our potential. As the philosophers have written, "What a drag it is gettin' old."

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

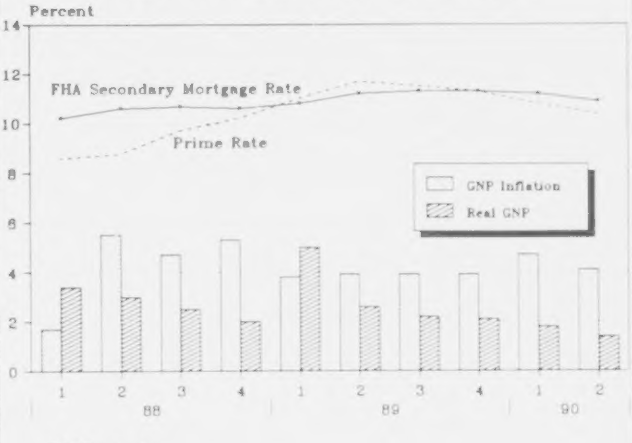
The recent revision by the U.S. Department of Commerce to its original estimate of 1988 fourth quarter real GNP growth reveals some important changes in the forces shaping economic growth. While the annual rate of growth remained at 2.0 percent, the revision raised the estimate for consumption expenditures to $22.2 billion and lowered its estimate of net export (exports-imports) growth to a negative $9.8 billion: these figures were originally reported as $18.1 billion and negative $6.8 billion, respectively. These new figures ran counter to the hopes of many economists who had expected that consumption growth would yield to export growth, thereby paving the way for a gradual economic slowdown or "soft landing." However, more recent indicators of the economy's health suggest that, at present, this economic expansion is still going strong. Reports on economic activity in the opening month of 1989 included substantial increases in employment, retail sales, housing starts and industrial production.

Higher Prices on the Horizon

While indicators point towards continued economic growth, the chances for a steady rise in the rate of inflation are also growing. For several years, modest wage increases have helped keep inflation in check despite strong economic growth. However, the production report for the fourth quarter of 1988 showed that even without higher wage demands, labor costs are indeed rising. While non-farm businesses responded to strong domestic and foreign demand by increasing output at a 3.6 percent annual rate, capacity constraints made it difficult to expand productivity (output per hours worked), which remained unchanged in the fourth quarter. As a result, those firms which increased production were forced, in many cases, to hire on new employees, leading to a 3.2 percent annual growth rate in employment. In the near term, production costs will rise if productivity gains fall significantly behind those for wages. The recent data shows unit labor costs surging ahead in the last quarter of 1988, jumping 5.5 percent in the non-farm business sector and 4.4 percent in the manufacturing industries.

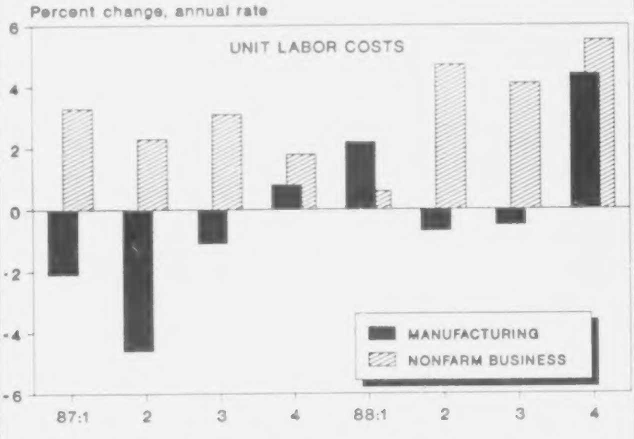
On the heels of this rise in unit labor costs, came a record leap in the producer price index. Prices at the wholesale level rose 1.0 percent in January, which translates into a 12.7 percent annual increase, marking the largest gain in producer prices in over three years. Admittedly, rising food and energy costs explained a large part of the price hike, but price increases of over 1 percent also hit books, passenger cars, jewelry, and children's goods. Rising producer prices generally are thought to indicate future inflation at the consumer level, as higher prices are passed from wholesaler to retailer to consumer. Consumer prices rose 7.2 percent at an annual rate in January, compared with annual rates of 3.7 and 4.1 percent in 1987 and 1988, respectively. The increase in the price index extended beyond the traditionally, volatile sectors: consumer prices rose 6.0 percent excluding food and energy.

GRAPH 1: THE ECONOMIC OUTLOOK



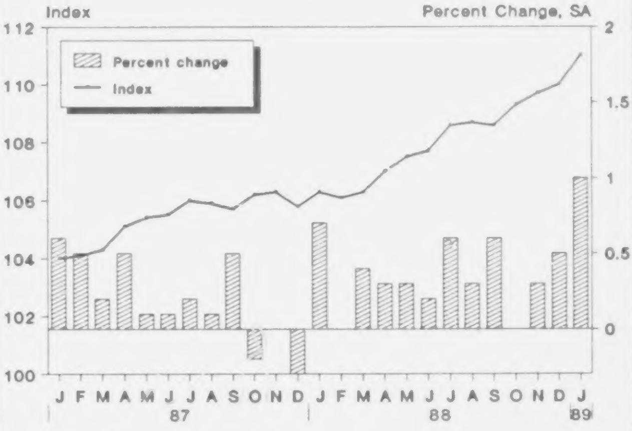
E NAR estimates

GRAPH 2: LABOR COSTS ARE RISING



Source: Bureau of Labor Statistics

GRAPH 3: PRICES SURGE AHEAD IN JANUARY



Source: Bureau of Labor Statistics

Monetary Policy and Interest Rates

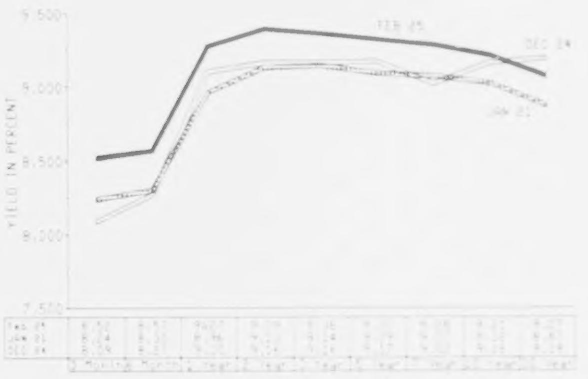
These recent indications of accelerating inflation have been aggravated somewhat by instability in the dollar and concerns over OPEC's new determination to raise oil prices. In light of these developments, financial markets have looked to the Fed for reassurances of its own resolve in the fight to control inflation. The Fed has been eager to demonstrate its resolve, pushing short-term interest rates up more than 300 basis points in recent months. In February alone, the Fed forced rates higher by muscling up the federal funds rate almost 3/4 of a percentage point higher to 9.75 percent. Over the course of this recent tightening, major banks responded by twice raising the prime rate by one-half a percent until it reached 11.5 percent. After months of credit tightening, the Fed finally raised the discount rate to 7 percent from 6.5 percent. The discount rate, which is the rate the Fed charges on overnight loans to banks, is considered one of the Fed's most powerful policy tools due to its status as lender of last resort. However, banks have become increasingly reluctant to borrow from the Fed and, with the spread between the federal funds rate and the discount rate remaining at almost 300 basis points, the Fed's latest discount rate hike will have little real effect on credit. More important, was the message behind the rate increase which was intended to underline the permanence of the Fed's commitment to a tighter credit policy and lower inflation. We do not expect to see any aggressive credit tightening in the near future, as financial markets and the Fed wait to see the effects of their latest efforts. Consequently, any substantial fall in interest rates during the remainder of 1989 is not likely. Instead, mortgage rates will hover between 11 and 11.5 percent before falling in 1990. Any interest rate forecast is borne of assumptions about economic growth, but the additional uncertainties of how a new President will work with Congress to address such weighty issues as the budget & trade deficits, the FSLIC bailout and international economic cooperation, add considerable risks to this forecast.

REAL ESTATE MARKETS

Housing Starts

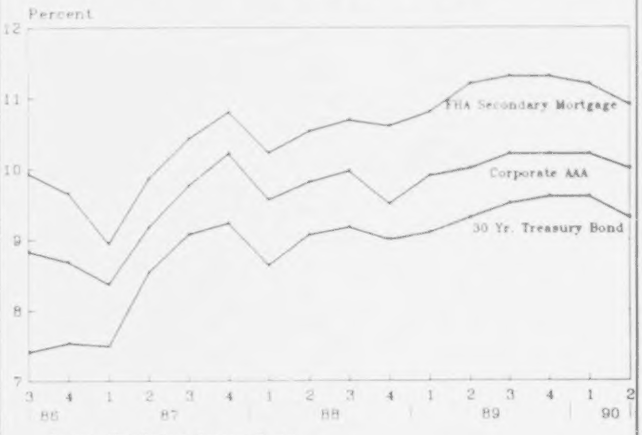
Encouraged by unseasonably warm weather and the remarkably fast pace of existing home sales during December, housing starts jumped 8 percent in January to a seasonally adjusted annual rate of 1.693 million units, the fastest rate since March of 1987. Single-family starts climbed 7.1 percent to a seasonally adjusted annual rate of 1.203 million units in January, their fastest rate in over 14 months, and 17.8 percent faster than a year ago. Multi-family starts were up 10.1 percent to a seasonally adjusted annual rate of 490 thousand units, 32.4 percent higher than the 370 thousand unit rate of a year ago. Housing starts are not expected to continue at their present rate. Rather, they are expected to yield to higher interest rates, slowing to a rate of 1.43 million units for most of 1989, and remaining at about 1.41 million units in 1990.

GRAPH 4: THE YIELD CURVE



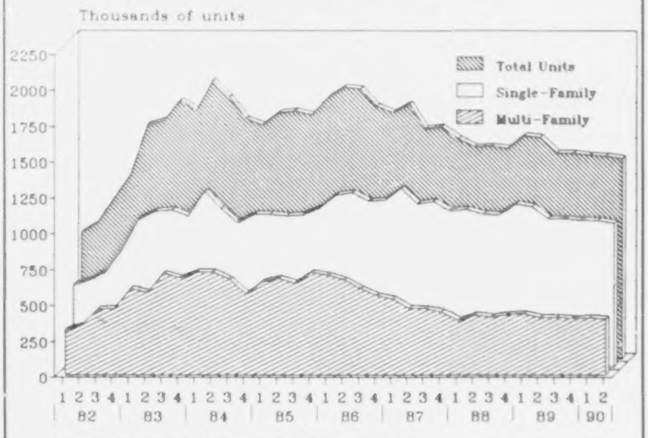
Source The Federal Reserve Board

GRAPH 5: LONG-TERM INTEREST RATES



Source The Federal Reserve Board

GRAPH 6: HOUSING STARTS



Source: The Bureau of Census, E NAR estimates

New Home Sales

Sales of new single-family homes reached an annual rate of 669 thousand units in December, up slightly from the November rate of 665 thousand units, and 14.2 percent faster than the 586 thousand unit pace of one year ago. While new home sales began 1988 at the relatively slow annual pace of 579 thousand units, sales climbed to finish 1988 with a total of 677 thousand new homes sold, just above the 1987 total of 671 thousand new homes. The continued strong demand for new homes, despite higher interest rates and the prospects for slower economic growth, helped to raise the median price of a new home by 7.7 percent during 1988, and encouraged housing starts throughout the year. This demand, however, is expected to yield to less favorable economic conditions in 1989, leading to an 4.7 percent drop in sales to a total of 645 thousand homes

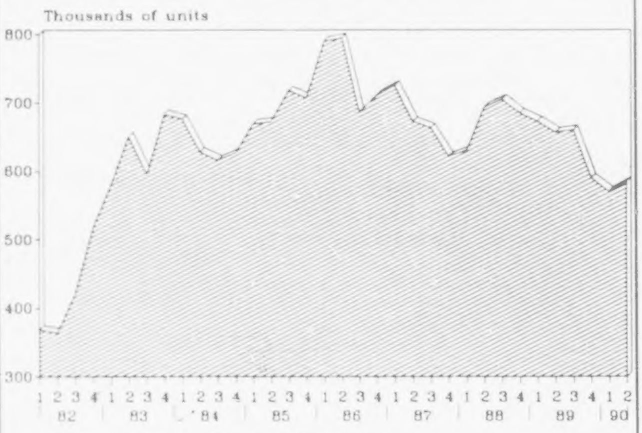
Existing Home Sales

Sales of existing single-family homes took a breather in January, slowing to a seasonally adjusted annual rate of 3.63 million units, or 7.4 percent below the December annual rate of 3.92 million units. The December rate had been fueled partly by an inventory clearance in the Southern market. A return to a more "normal" sales pace in the South caused most of the national decline in existing home sales during January. The January rate was, however, exceptionally strong in its own right, as illustrated by the 13.4 percent increase over the January 1988 sales rate of 3.2 million units. The outlook for existing single-family home sales over the next year is reasonably bright, despite the expected rise in mortgage interest rates. Rising interest rates on both fixed and adjustable rate mortgages are expected to slow the housing market in the coming months. However, the wide acceptance of ARM's will continue to provide potential homebuyers with the means to purchase homes that would be otherwise unaffordable with a fixed rate mortgage. The sales pace of existing single-family homes will likely reach an average annual rate of 3.56 million units in the present quarter, and likely quicken in the coming peak sales season to an annual rate of about 3.68 million units. Total sales are expected to remain almost even with 1988, totaling 3.58 million units in 1989.

Home prices

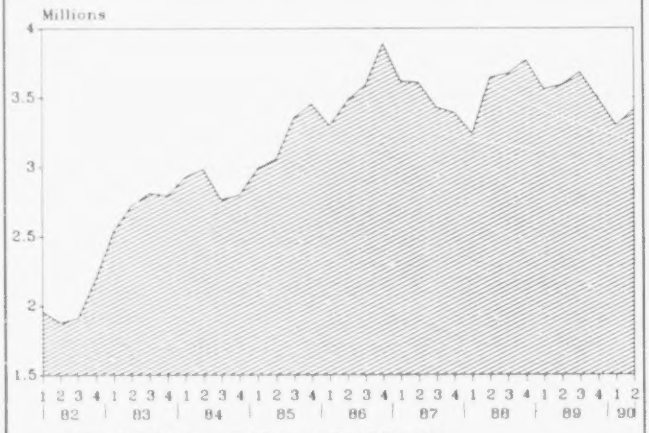
The January median existing single-family home price rose to $91,500, a 3.6 percent increase from the December median price of $88,700. However, even with this sizable monthly increase, the January median price was just 3.9 percent above January 1988, reflecting the modest increase in home prices during 1988. The upward pressure on prices in January came mainly from the South where prices rose 8.3 percent to $84,700 from its December low of $78,000. Prices also rose by 1.9 percent in the West to $131,100 (up 9.9 percent over 1988), and 2.2 percent in the Midwest to $69,000 (up 2.1 percent over 1988). In the Northeast, after rising 1.6 percent in December, the median existing home price fell 1.3 percent in January to $141,100.

GRAPH 7: NEW HOME SALES



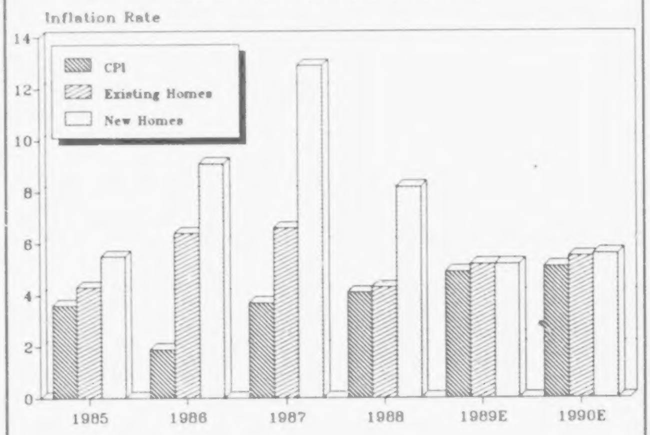
Source: The Bureau of Census; E NAR Estimates

GRAPH 8: EXISTING SINGLE-FAMILY HOME SALES



Source: NAR Economics and Research; E NAR Estimates

GRAPH 9: HOME PRICES



Source. NAR; E NAR Estimates

REGIONAL DATA

Housing Starts

Not surprisingly, the mild weather during December and January had its greatest effect on housing starts in the Northeast, which shot up by 51.8 percent in January to a seasonally adjusted annual rate of 296 thousand units. While frozen ground and freezing temperatures generally slow construction, two months of temperatures in the high 30s and low 40s allowed developers in the Northeast to get a jump on their Spring construction. Although the January rate was the fastest seen since February of last year, it was still 10.3 percent slower than the January 1988 pace, when houses were started at an annual rate of 330 thousand units. The South and the West also experienced increases in the rate of starts, rising 3.0 and 4.4 percent, respectively. In the South, the 616 thousand unit annual rate was 33.9 percent faster than a year ago, while in the West, the 449 thousand unit rate was 18.8 percent above the January 1988 rate. The Midwest was the only region to experience a decline, falling 3.8 percent to an annual rate of 332 thousand units. However, January housing activity in the Midwest was up 44.9 percent over the 223 thousand unit rate set a year earlier.

New Home Sales

The moderate December increase in new home sales masked large swings occurring at the regional level. The greatest change took place in the Northeast, where sales jumped 52.9 percent to a seasonally adjusted annual rate of 104 thousand units. Moving in the opposite direction, sales in the Midwest fell 22.1 percent to an annual rate of 88 thousand units, putting sales at their slowest pace since May of 1987. In the West, sales fell by a modest 1.3 percent to a seasonally adjusted annual rate of 229 thousand units. Sales in the South dropped 2.0 percent to an annual rate of 248 thousand units. Over the course of 1988, sales grew in every region except the Northeast, where sales fell by 13.7 percent to a total of 101 thousand units. In the West, 1988 new home sales were up 9.6 percent to 204 thousand homes. In the Midwest and the South, sales grew by 1 percent with 98 thousand and 274 thousand units sold, respectively.

Existing Home Sales

The rate of existing single family home sales dropped for every region except the Northeast during January. The largest decline came in the South where sales fell to 1.31 million units, or 12.6 percent below the December annual rate of 1.5 million units. In the Midwest, existing home sales slowed by 5.9 percent to an annual rate of 950 thousand units. Sales were down 8.6 percent in the West at an annual rate of 640 thousand units, a rate 23.1 percent faster than a year ago. Sales increased in the Northeast by a modest 1.4 percent to an annual rate of 710 thousand units.

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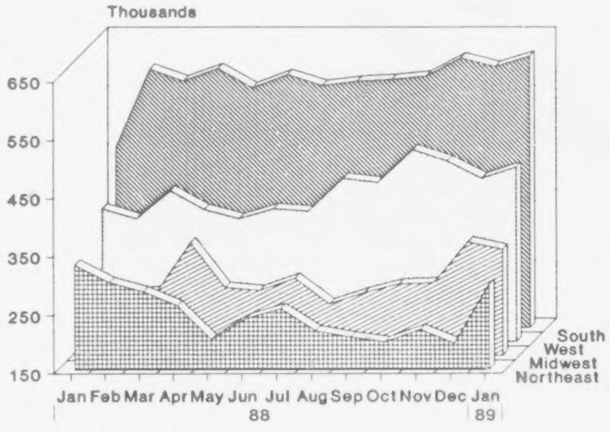
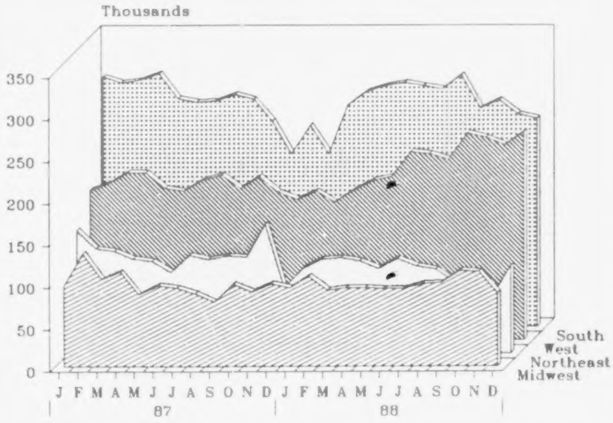
GRAPH 10: HOUSING STARTS BY REGION



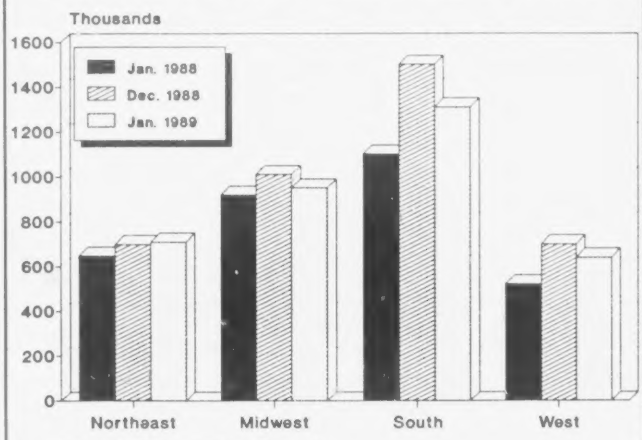
Source: Bureau of Census

GRAPH 11: NEW HOME SALES BY REGION



Source: Bureau of Census

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics and Research

PRESIDENT BUSH'S BUDGET PROPOSALS AND HOUSING

OVERVIEW

President Bush presented a $1.6 trillion budget which overall is not much different from the Reagan Budget. The Budget proposes to keep the military budget at the level of inflation for one year and features selective spending increases and decreases in domestic programs. The most striking differences from the Reagan budget include proposals to reduce the taxation of capital gains, tax breaks for independent oil and gas drillers, enterprise zone tax incentives, and a reduction in the growth in Medicare payments.

The housing sector may be affected by changes in the budget in a variety of ways. The discussion below highlights proposals which have either a direct or indirect influence on the housing sector.

PREFERENTIAL TREATMENT OF CAPITAL GAINS FOR INDIVIDUALS

The budget proposes restoring a capital gains tax differential on gains from qualified assets sold by individual taxpayers. This proposal reflects the Presidents belief that lower capital gains rates will stimulate investment and economic growth and create additional jobs. It is expected that the lower capital gains rate will increase capital gains realizations significantly in the short run, and lead to increased economic growth in the long run. Thus, receipts are expected to increase due to this proposal. The Administration anticipates a $4.8 billion increase in receipts for fiscal year 1990. Other motivations for this proposal include the desire to correct for the taxation of purely inflationary gains, to reduce the tax bias toward debt finance, and to promote U.S. international competitiveness.

The Proposal

Specifically, under the proposal, individuals are allowed to exclude 45 percent of qualifying capital gains. For individuals with marginal income tax rates of 28 percent, or 33 percent, a 15 percent maximum tax rate will apply to qualified capital gains. Low income taxpayers (married taxpayers with adjusted gross income (AGI) below $20,000 and single taxpayers with AGI below $10,000) are allowed a 100 percent exclusion of gains on qualified assets.

In order to be eligible for preferential treatment, qualified capital assets must be held for at least 12 months if sold between June 30, 1989 and the end of calendar year 1992; 24 months if sold between 1993 and 1994; and 36 months if sold in 1995 or later.

The proposal retains the current law definition of a capital asset. However, certain assets are excluded from preferential treatment. These include (1) buildings, equipment, or other depreciable property if such assets are used in a trade or business y(including intangible assets subject to amortization), (2) depletable property if used in a trade or business, and (3) "collectibles" of a type in which IRAs cannot invest (e.g., works of art, antiques, stamps, and certain coins). In addition "special section 1231 assets" which include certain interests in timber, coal, iron ore, and livestock are ineligible for the reduced capital gains tax. The proposal does allow preferential treatment for gains on nondepreciable property that is used in a trade or business unless held for sale in the ordinary course of business. The proposal does not affect the treatment of gain on sale of a principal residence. Generally the gain is excluded from taxation due to the rollover provision and the $125,000 exclusion provision under current law.

Implications for the Real Estate Sector

The proposal excludes buildings but includes land (unless the individual is a dealer) used in a trade or business. Theoretically, this proposal could affect the real estate sector in at least two major ways. First, since the proposed change, if enacted, could reduce the return from real estate relative to other assets (such as stocks), investment in real estate could tend to decline since it becomes less attractive. Second, such a change might bias the intensity of land development since land is given preferential treatment while structures are not. In general, a proposal which taxes structures more heavily than land is not considered good economic policy unless the objective is to slow down land development and reduce structural density.

Other Implications

The proposed differential would reduce the cost of capital relative to labor. To the extent that there is a strong substitution effect, employment will not rise as much, and/or wages may not rise as much relative to a situation where the differential tax treatment did not exist.

The proposal provides greater incentive to convert ordinary income to capital gains. Thus, taxpayers will find it beneficial to switch from assets which yield high dividend and low capital gains to assets which yield low dividends and high capital gains, since dividend income is taxed at ordinary income tax rates, while capital gains income would be taxed at a lower rate, under the proposal. Workers would attempt to benefit from the proposed reduction in the capital gains tax rate by receiving some of their wages and salary income in the form of incentive stock options. This behavior would also change the relative prices of assets, with tax preferred assets rising in price relative to non-tax preferred assets.

However, if the main concern of this type of proposal is to stimulate investment and economic growth, it is better to reduce the tax rate on income from capital than to reduce the tax rate on income from the gains from capital.

ENTERPRISE ZONE TAX INCENTIVES

The budget also includes a proposal for enterprise zones to encourage private industry investment and job creation in economically distressed areas. Enterprise zones are expected to lead to the revitalization of economically distressed areas by removing regulatory and other barriers inhibiting growth, and employment and tax incentives. The President advocates "creative partnerships" between government and the private sector to increase the opportunity for economically distressed areas and encourages states to join with the Federal Government by extending their own incentives and regulatory relief in enterprise zones.

Under the proposal, up to 70 zones will be selected between 1990 and 1993 to receive unspecified employment and tax incentives, and regulatory relief. The tax incentives would be both capital-based and employment-based, leading to estimated revenue losses of $150 million in 1990 and totalling to $1.05 billion over four years. The subsidy for a given enterprise zone would be larger in the early years, declining over time. The states' and localities' willingness to match Federal incentives are considerations which would affect the selection of the enterprise zones.

HOMELESSNESS

The President is proposing a new initiative for the homeless in addition to fully funding the McKinney Act. The budget proposes funding the McKinney Act up to the authorized level of $746 million. This includes $676 million of discretionary funding for programs to provide emergency food and shelter, transitional and permanent housing, and other needed services.

Moreover, a new $50 million initiative proposed by Bush is designed to (1) help homeless families and children move out of welfare hotels and into transitional or permanent housing, (2) provide a coordinated package of services and shelter for the homeless mentally ill, and (3) make resources available on a flexible basis for communities to meet specific needs of homeless people in their areas. The details of this plan have not yet been disclosed, but the budget document indicates that states and localities would have much discretion in helping the homeless once selected. The selection would be on a competitive basis and requires matching funds.

President Bush's budget also includes other programs to help the homeless, including HUD efforts to provide funds for construction of permanent housing specifically to meet the needs of the mentally ill and elderly. In total, the 1990 budget includes over $1 billion for the homeless.

VETERANS HOUSING

President Bush does not incorporate the Reagan proposal to raise the fee charged on the Department of Veterans Affairs (VA) guaranteed housing loans and vendee loans from the current 1 percent to 3.8 percent of the mortgage amount (vendee loans are direct loans made to both veterans and non-veterans who purchase property that the VA has acquired through prior defaults).

CREDIT REFORM

President Bush supports recent legislation proposed by Reagan to change the budgetary treatment of credit programs to attempt to measure a subsidy cost of direct loans and loan guarantees and to require appropriations for these costs. Office of Management and and Budget (OMB) believe there is a subsidy involved in direct loans or loans guaranteed by the Federal government either because the government provides a lower interest rate, or because it guarantees or grants loans to those who would not be able to borrow at all or would be subject to higher interest rates in the private market. Note, that this proposal would have no effect on the deficit.

Current Budget Treatment

Under current budget treatment, the full amount of a direct Federal loan is treated as an outlay when the loan is made, then interest and principal repayments are shown as offsetting collections in later years. For loan guarantees, any intitial premium shows up as an offsetting collection when the loan is made, and no cost is shown in subsequent years unless there is a default. Under the Reagan/Bush proposal, this theoretical cost of the lending programs would be estimated.

Proposed Calculation Method

The Reagan Administration proposed to estimate these subsidy costs by calculating the present value of the cash flow from Federal loans and loan guarantees using comparable private sector internal rates of return. In the original draft bill, the Administration had proposed that newly made direct loans be sold immediately and competitively to measure these subsidy costs. It also proposed that reinsurance for loan guarantees be gradually phased-in as the market for reinsurance developed.

Current Budget Status

President Bush has not yet put forth the specific line item details of his budget, but under the Reagan Budget, the housing sector is projected to account for $75 billion or 60 percent of all new direct and guaranteed loan commitments in 1990. The Reagan Administration estimated the credit cost to housing at over $3 billion. The credit cost to housing is projected to be 34 percent of loan credit cost to all sectors.

The National Association of REALTORS® has expressed their concerns over the Credit Reform Proposal to OMB policmakers stating that the proposal, if enacted, would tend to worsen housing affordability; would legislatively define "subsidy" in a way inconsistent with common usage and create the false appearance that self-supporting programs, such as the Federal Housing Administration (FHA) Mutual Mortgage Insurance Fund and the Government National Mortgage Association (GNMA) mortgage-backed securities guarantee program, are subsidized. The NAR position also points out that the proposal would discriminatorily apply this definition *only* to government credit activities and would introduce very complex decision mechanisms resulting in uncertainty about the availability of housing credit.

HOUSING CREDIT AND USER FEES

The Bush proposal changes the Reagan proposal on housing credit fees *only* by deleting the VA housing origination fee increase. In general his budget approach is to start from the FY 1989 actual spending amounts and propose selective departures from those amounts as necessary or as he considers important. This would preserve a portion of the $81.5 billion increase in revenues from FY 1989 to 1990, for deficit reduction.

The Reagan Budget proposed levying user fees on a number of government-sponsored enterprises (including the Federal Home Loan Mortgage Corporation) in order to reduce or eliminate their competitive advantage. The Reagan Administration proposed to raise the fee paid to the Government National Mortgage Association (GNMA) for guaranteeing mortgage-backed securities. The fee would be raised from 6 basis points to 10 basis points by 1991 and to 15 basis points by 1992. The previous Administration also proposed a similar fee increase for the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

The Federal government imposes credit limits on new loan commitments guaranteed by GNMA or insured by the FHA. GNMA supports the mortgage market by guaranteeing mortgage-backed securities that are issued by private lenders and backed by mortgages insured by the FHA or guaranteed by VA. For 1990, the Reagan Administration proposed a new commitment limitation of $75 billion on GNMA guarantees and $67 billion on FHA guarantees. At this writing, these limitations are not expected to be binding, since the Administration estimated that new commitments under both GNMA and FHA are $66 billion and $59 billion - below the limitation amounts. The specific line item details of President Bush's Budget have not yet been revealed, but he has proposed no change in these amounts for Fiscal Year 1990.

The Association's current position on the proposed fee increases and the credit authority limitations are that the proposed "user fees" would far exceed these programs' costs amounting to a tax on housing; and the credit authority limitations proposed for FHA Mutual Mortgage Insurance and for GNMA are adequate to support the volume of market activity that is anticipated.

OTHER HOUSING PROPOSALS

Other Reagan proposals include replacement of Section 202 direct loans (for rental or cooperative housing facilities for the elderly or handicapped) with $78 million in credit vouchers, and continuation of the 1988 rural housing voucher initiative operated jointly by the Department of Housing and Urban Development (HUD) and the Farmers Home Administration (FmHA). Bush endorses Reagan's proposed 20,000 rural housing vouchers to be funded by FmHA, and $100 million in direct loans for multi-family housing construction targeted to areas experiencing housing shortages.

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U.S. ECONOMIC OUTLOOK

MARCH 1989

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL			FORECAST	
	88.3	88.4	89.1	89.2	89.3	89.4	90.1	90.2	1986	1987	1988	1989	1990
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4909	4995	5106	5189	5266	5345	5430	5504	4240	4527	4863	5226	5545
% Change	7.3	7.2	9.1	6.7	6.1	6.1	6.5	5.6	5.6	6.8	7.4	7.5	6.1
% Change (w/out inflation)	2.5	2.0	5.0	2.6	2.2	2.1	1.8	1.4	2.8	3.4	3.8	3.0	1.9
Consumer Price Inflation (CPI)	4.8	4.4	5.3	5.0	4.7	4.9	5.4	5.2	1.9	3.7	4.1	4.9	5.1
GNP Inflation (GNP Deflator)	4.7	5.3	3.8	3.9	3.9	3.9	4.7	4.1	2.7	3.3	3.4	4.4	4.2
Unemployment Rate - Civilian	5.5	5.3	5.3	5.3	5.2	5.2	5.2	5.4	7.0	6.2	5.5	5.3	5.4
Civilian Employment-Household Basis (millions)	115.2	115.8	116.9	117.4	118.0	118.4	118.8	119.0	109.6	112.4	115.0	117.7	119.2
Percent change	2.0	2.2	3.6	2.0	1.8	1.6	1.2	0.8	2.3	2.6	2.3	2.3	1.3
Index of Industrial Production	138.4	140.0	141.2	141.8	142.6	143.4	143.8	144.0	125.1	129.8	137.2	142.2	144.3
Manufacturing Capacity Utilization	84.0	84.4	84.8	85.0	85.0	84.9	84.8	84.7	79.7	81.0	83.6	84.9	84.5
Domestic Auto Sales	7.6	7.5	6.8	7.5	7.1	7.3	7.3	7.2	8.2	7.1	7.5	7.2	7.1
Federal Tax Receipts (NIPA) as % of GNP	19.9	19.8	20.0	20.2	20.3	20.4	20.8	20.7	19.5	20.2	20.0	20.2	20.7
Federal Expenditures (NIPA) as % of GNP	22.4	23.0	23.0	22.9	22.8	22.8	23.0	23.0	24.4	23.7	23.0	22.9	23.0
Deficit(NIPA)	-123.5	-160.9	-152.9	-136.3	-133.6	-130.4	-119.1	-123.2	-205.6	-157.8	-143.2	-138.3	-124.9
as % of GNP	-2.5	-3.2	-3.0	-2.6	-2.5	-2.4	-2.2	-2.2	-4.9	-3.5	-2.9	-2.6	-2.3
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4692	4868	4643	4590	4679	4483	4292	4382	4712	4648	4649	4599	4332
Percent change – year ago	3.6	9.5	-2.0	-1.7	-0.3	-7.9	-7.6	-4.5	10.8	-1.4	0.0	-1.1	-5.8
Existing Single-family Home Sales (thousands)	3663	3770	3560	3590	3680	3490	3305	3410	3565	3526	3594	3580	3347
Percent change – year ago	6.8	11.2	7.9	-1.5	0.5	-7.4	-7.2	-5.0	10.9	-1.1	1.9	-0.4	-6.5
Housing Starts (thousands)	1467	1556	1544	1433	1433	1420	1415	1396	1812	1634	1495	1458	1413
Percent change – year ago	-9.4	1.5	4.6	-3.2	-2.3	-8.7	-8.4	-2.6	4.1	-9.8	-8.5	-2.5	-3.0
Single-Family Units	1061	1132	1117	1031	1030	1024	1018	1002	1183	1157	1088	1051	1015
Percent change – year ago	-8.1	3.9	1.8	-2.9	-2.9	-9.5	-8.8	-2.9	10.4	-2.2	-5.9	-3.4	-3.4
Multi-Family Units	406	423	428	402	403	396	397	395	630	477	407	407	398
2-4 Family Units	57	66	66	62	63	61	62	61	85	66	59	63	62
Percent change – year ago	3.0	16.6	17.8	8.7	9.7	-6.6	-7.2	-1.8	-9.0	-22.6	-10.1	6.9	-2.2
5 + Family Units	349	358	361	340	341	334	336	333	545	412	348	344	336
Percent change – year ago	-14.7	-7.5	11.7	-5.9	-2.4	-6.5	-7.2	-1.8	-5.6	-24.4	-15.5	-1.1	-2.2
New Single-family Home Sales (thousands)	703	685	673	657	660	590	570	585	750	671	677	645	585
Percent change – year ago	4.1	10.3	6.8	-5.7	-6.1	-13.9	-15.3	-11.0	9.0	-10.5	0.9	-4.7	-9.3
HOME PRICES													
Existing Home Prices - Median $(1000)	90.1	88.3	91.4	93.3	95.2	95.9	96.2	98.1	80.3	85.6	89.3	94.0	99.1
Percent change – year ago	5.4	3.9	4.1	4.9	5.7	8.6	5.3	5.1	6.4	6.6	4.3	5.2	5.5
New Home Prices - Median $(1000)	114.9	114.9	115.6	117.9	119.4	120.4	121.0	123.4	92.0	104.0	112.5	118.3	125.0
Percent change – year ago	8.2	2.8	2.4	4.4	3.9	4.8	4.7	4.7	9.1	12.9	8.2	5.2	5.6
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.7	10.6	10.8	11.2	11.3	11.3	11.2	10.9	9.9	10.2	10.5	11.1	10.7
1-year ARM (without buydown)	8.3	8.5	8.8	9.2	9.2	9.0	8.7	8.6	9.5	8.5	8.5	9.0	8.6
Corporate AAA Bond Rate	10.0	9.5	9.9	10.0	10.2	10.2	10.2	10.0	9.0	9.4	9.7	10.1	9.9
Government Bond Rate	9.2	9.0	9.1	9.3	9.5	9.6	9.6	9.3	7.8	8.6	9.0	9.4	9.4
Short-Term Interest Rates													
Federal Funds Rate	8.0	8.5	9.5	10.0	9.8	9.5	9.0	8.8	6.8	6.7	7.6	9.7	8.8
3-month T-Bill Rate	7.0	7.7	8.5	8.9	8.8	8.5	8.0	7.8	6.0	5.8	6.7	8.7	7.8
Prime Rate	9.7	10.2	11.0	11.7	11.5	11.3	10.8	10.4	8.3	8.2	9.3	11.4	10.4
Discount Rate	6.3	6.5	6.7	7.0	7.0	6.9	6.8	6.6	6.3	5.7	6.2	6.9	6.6
Value of the U.S. Dollar (Trade-Weighted Avg.)	97.6	93.0	94.6	93.6	91.1	88.0	86.0	84.0	112.3	96.9	92.8	91.8	84.5
Percent change	35.6	-17.6	7.2	-4.2	-10.1	-13.2	-8.5	-9.0	-21.6	-13.6	-4.3	-1.0	-8.0

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz.

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REAL ESTATE OUTLOOK

Vol. 2, No. 4

April 1989

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The U.S. Department of Commerce recently announced its second revision to fourth quarter real GNP growth, reporting an annual rate of growth of 2.4 percent. Economic growth in the non-farm sector during the fourth quarter was quite strong, advancing at an annual rate of 3.5 percent.
- Indicators of the strength of non-farm growth so far in 1989 have been pretty mixed: signs of an economic boom (and accelerating inflation) in the January statistics were quickly countered by February declines in retail sales, factory operating rates, durable goods orders, housing starts, home sales, and the index of leading indicators. The coming months will show whether economic activity in February was a reaction to tighter credit or the beginning of a slowdown in the rate of growth.
- Recent advances in short-term U.S. interest rates have once again increased demand for U.S. dollars, leading to a rise in the dollar's value and further complicating efforts to curb the trade deficit.
- Housing starts slowed 11.4 percent in February to an annual rate of 1.498 million units, from the 1.69 million unit pace of January. The decline was caused by colder, more seasonable weather, and the February leap in interest rates.
- Sales of new single-family homes fell to an annual rate of 626 thousand units in February, 9.4 percent below the revised January sales rate of 691 thousand units (originally reported as 704 thousand units), and 4.6 percent below the 656 thousand unit rate of a year ago.
- Existing single-family home sales slipped 3.1 percent in February to an annual rate of 3.44 million units. While the February sales figures were the slowest since the beginning of the last homebuying season in March 1988, they were still 3.6 percent ahead of the February 1988 sales pace.
- The price of an existing single family home rose 3.8 percent in February to a new high of $93,100. This price is 4.7 percent above the $88,900 median price of one year ago. Meanwhile, the median price of a new single-family home rose 8.9 percent to $123,000, from $113,000 in January.

IN THIS ISSUE

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Forecasting & Policy Analysis Division
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LIES, DAMNED LIES AND STATISTICS

Economic Commentary

by
John A. Tuccillo
Chief Economist
and Senior Vice President
Real Estate Finance

One of the major arithmetic breakthroughs of this past year has been the statistical explosion that has occurred during the recent college basketball season. Suddenly, we read in the papers that good ol' State U. is 19-1 when its opponents shoot less than 44 percent during the last two minutes of each half. Or Seth Thomas University (affectionately known in some cities as Tick Tock Tech) is 27-6 when leading by more than 6.38 points at halftime. I've been waiting for the ultimate statistical insight: Wassamatta U. is undefeated when it scores more points than the other team. This of course is merely a paraphrase of Calvin Coolidge's dazzling dictum, "When more and more people are thrown out of work, unemployment results."

These thoughts may seem unduly cynical from one who derives at least part of his living being responsible for the exposition of numbers about both the housing sector and the economy. Think of it as quality control. Just as the average REALTOR® does not want the profession seen as less professional than it really is, so too, we who deal with numbers don't want to see the public led down the garden path by the creator of the sexy, but ultimately meaningless number. And that seems to be happening a great deal lately.

We know that the Federal Reserve is actively battling inflation by slowing the economy through higher interest rates. But the welter of statistics we see in the daily papers and on business news programs seem to be pointing in very different, if not opposite directions. Does one believe that inflation is rampant, because the February Producer Price Index is up a full percentage point (more than expected), or should we be reassured that the Fed has been successful, because the Consumer Price Index for February is up only 0.4 percent (less than expected)? It would be nice to answer "damned if I know!", but the fact is we need to know the real answer.

With all of the numbers that are thrown at us--some because they are important; others because it will get their issuer publicity--it's time for a kind of Reader's Guide to Economic Data. So, here's our effort:

1. **Numbers don't matter; what they represent does.** Inflation, for example, is a problem only if the core rate of inflation for the economy is rising. In February, the Producer Price Index rose dramatically because of food and energy price jumps. Now if the OPEC nations can hold together and continue to push up the price of oil and/or the drought of 1988 becomes the drought of 1989, then the increases we saw do indicate a rise in the core rate of inflation. If not, then these are short-term increases, and inflation will not be a continuing problem. As with any economic question, look behind the number, and see the meaning.

2. **Weekly numbers are not worth printing; monthly numbers may be little better.** The only weekly number that should have any validity in your lives is the number on your pay stub. In the world of economics, weekly numbers are the product of random static, and events take shape only over much longer periods. Most statistics watchers have discovered this through painful experience with weekly money supply numbers, although the emphasis placed on the monthly trade numbers suggest that they didn't learn much. Granted, those of you who are active traders should rely on the short term numbers; but anyone who uses the *Wall Street Journal's* "Credit Markets" column to forecast interest rates is simply not seeing the forest.

3. **Some popular numbers simply don't matter.** The Dow Jones Industrial Average, like the national political conventions and the Academy Award presentations, is essentially a private party that has no business being thrust on the consciousness of the average American. We found out after the Crash how little that number either says about, or influences, economic life. Not every economic or financial fact that reaches the public media deserves your attention.

4. **Figures don't lie; but liars figure.** Statistics are meaningful only in context, and without the context they take on the flavor of "Three out of four doctors recommended asparagus souffle for a fever." These guys, of course, could be Dr. Seuss, Dr. J. and Doctor Doolittle, and without that backup, you really can't be sure of the real meaning of the numbers. Most statistics are best seen within their historical sweep. It's often more important to know whether a figure is high by seasonal or historical standards rather than that it is simply high.

So, where does this leave us. Essentially, any worthy commentator ought to give you information that follows the rules listed above. The role of the professional economist, like the role of the REALTOR®, is to organize and analyze information to the best advantage of his audience. Any less is a real abdication of responsibility. With this in mind, be selective of your sources, read deeply and seek meaning rather than simply a number. And remember--as much as we would like it, not every one is above average.

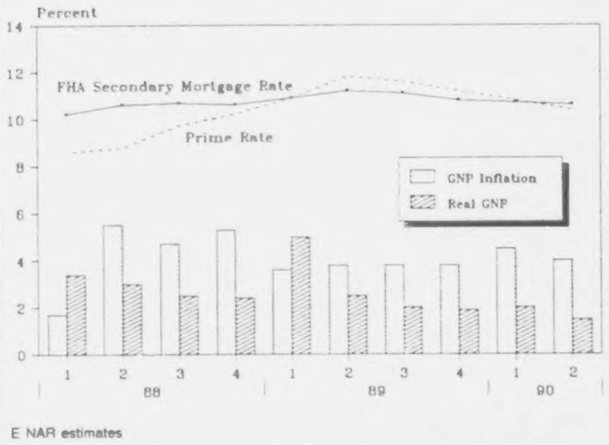
Outlook for the Economy and Real Estate

ECONOMIC OUTLOOK

The U.S. Department of Commerce recently announced its second revision to fourth quarter real GNP growth, reporting an annual rate of growth of 2.4 percent. Economic growth in the non-farm sector during the fourth quarter was quite strong, advancing at an annual rate of 3.5 percent. The GNP statistics will continue to be clouded by effects of the drought of 1988 at least through the first quarter of this year. In preparing their estimate of first quarter 1989 real GNP growth, Commerce Department economists will add a full 2.5 percentage points to their figures in order to account for an expected resurgence of farm production to a more normal level. This is not to say that they expect a very early harvest this year, say, sometime late last month. Rather, the Commerce Department estimates annual farm production early in the year and distributes this amount fairly evenly among the four quarters. Therefore, the greatest quarterly change in farm production will come in the first quarter GNP estimate. However, most of the attention focused on that release (on April 26) will be on the non-farm component of GNP growth.

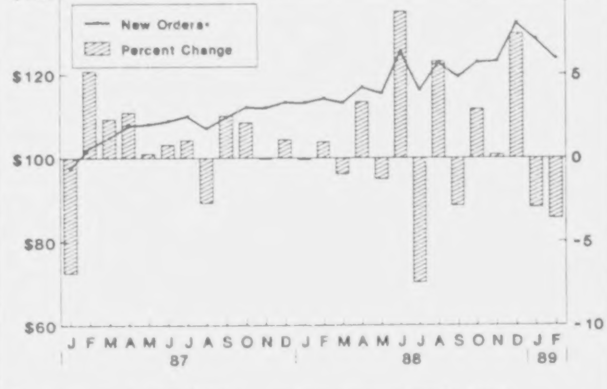
To date, indicators of the strength of non-farm growth so far in 1989 have been pretty mixed: signs of an economic boom (and accelerating inflation) in the January statistics were quickly countered by February declines in retail sales, factory operating rates, durable goods orders, housing starts, home sales, and the index of leading indicators. For example, new orders for manufactured durable goods slowed by 3.6 percent in February, marking the first back to back drop in three years (orders fell 2.9 percent in January). Orders for non-defense capital goods, a good gauge of business investment, fell 8.9 percent. A slower pace of durable goods orders is important because it could ease the mounting pressure on operating rates at factories that has raised costs and threatened to increase wage demands. Uncertain indicators notwithstanding, the Fed is focused on containing the inflation beast in a cage of tight money and high short-term interest rates. The coming months will show whether economic activity in February was a reaction to this tighter credit policy or the beginning of a slowdown in the rate of growth. We suspect it was a little of both, and we expect that real GNP growth will slow moderately in 1989 to 3.0 percent, from 3.8 percent in 1988.

The Fed remains very concerned about the prospects for accelerating inflation for what seem to be two reasons. First, the Fed's recent actions stem partly from big increases in domestic price indexes: for example, the Producer Price Index jumped 1.0 percent in January and February. However, other inflation barometers, like the Survey of Purchasing Managers and the Consumer Price Index (CPI) are less conclusive. In the latest Purchasing Manager survey, only 38 percent reported higher prices during February, the smallest share since March 1987. Also, after jumping 0.6 percent in January, the CPI rose a modest 0.4 percent in February. Graph 3 shows that the tendency for producer prices to feed into consumer prices has been muted recently. The second reason for the Fed's concern is not so much the rate of economic growth, but rather the level of national output. That is, many industries seem to be operating at or near their capacity, with employment at very high levels, and this has contributed to a build up of inflationary pressures.



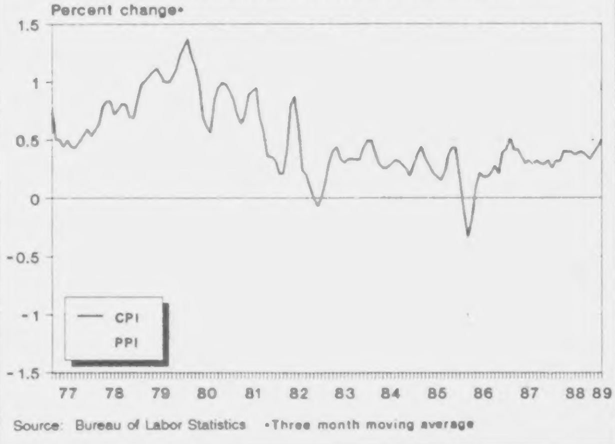
GRAPH 1: THE ECONOMIC OUTLOOK

E NAR estimates



GRAPH 2: THE ECONOMY SHOWS SIGNS OF SLOWER GROWTH

Source: Bureau of Labor Statistics •For Manufactured Durable Goods



GRAPH 3: PRODUCER PRICES ARE UP.. WILL CONSUMER PRICES FOLLOW?

Source: Bureau of Labor Statistics •Three month moving average

In addition to the domestic inflation barometers, the U.S. merchandise trade deficit has to be watched for its potential effects on the rate of inflation and the course of monetary policy. Recent advances in short-term U.S. interest rates have once again increased demand for U.S. dollars, which has in turn led to a rise in the dollar's value. On the surface, a stronger dollar sounds good (anything American that's stronger has got to be better), and if the change were to stick, it would help American consumers buy more imports. However, a stronger dollar is actually more a hindrance than a help in the ongoing process of eliminating the U.S. trade deficit. A stronger dollar complicates efforts to curb the trade deficit by expanding exports and slowing imports. In fact, after falling by 27.7 percent in the first three quarters of 1988, the trade deficit grew 9.3 percent in the fourth. Further, considerable improvement is not likely in the second quarter of 1989, without a substantial fall in the dollar. Recently, the G-7 nations seem to have set a cap on the value of the dollar at 1.9 marks and 140 yen, leading to speculation that the Fed will come under pressure to intervene in international currency markets if the dollar approaches these levels. To intervene, the Fed sells dollars to lower its value, but this in turn increases the U.S. money supply thereby offsetting the Fed's own efforts to restrict credit here at home.

Monetary Policy and Interest Rates

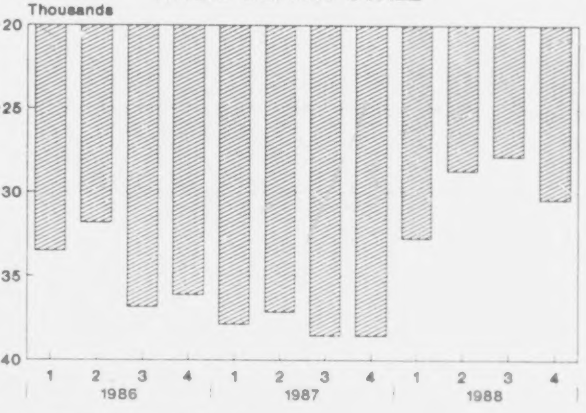
Regarding the Fed's efforts on the domestic front, the monetary authority presently appears to be evaluating the effectiveness of its earlier credit tightening. With most indicators pointing towards an easing of economic growth, it would seem unlikely for the Fed to move very aggressively on short-term rates unless new indications of a stronger economy emerge. The Fed hopes that the next few months will show that its anti-inflationary tactics have paid off, leading to a gradual slowing of the economy. Still, many analysts argue that all of the interest rate hikes of the past several months may not be enough to slow the economy's momentum and forestall the onset of high rates of inflation. We do not concur. Rather, we believe that a few more adjustments in short-term interest rates may be necessary to slow the economy, but that interest rates will trend down beginning in the second half of this year. In sum, the often competing demands of price stability at home and international confidence in the dollar will continue to challenge the Fed in the months ahead, and maintain some upside risks to the interest rate forecast.

REAL ESTATE MARKETS

Housing Starts

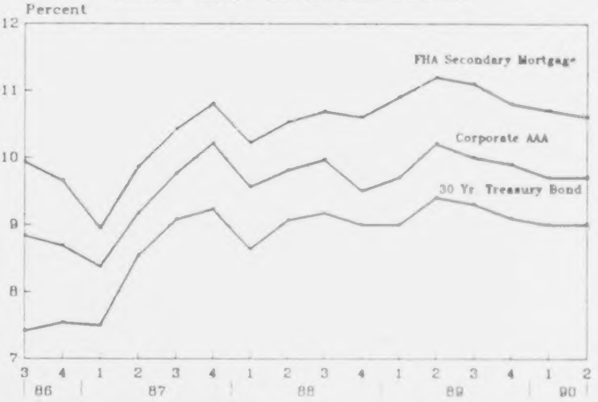
Housing starts slowed 11.4 percent in February to an annual rate of 1.498 million units, from the 1.69 million unit pace of January. The decline was caused by colder, more seasonable weather, and the February leap in interest rates. Single-family starts, after reaching a 16 month high in January at an annual rate of 1.202 million units, fell 13.1 percent to 1.045 million units, putting single-family starts 4.6 percent below the 1.095 million unit rate of a year ago and marking the largest monthly decline since March 1984. Starts of multi-family structures with 2-4 units dropped 6.0 percent to an annual rate of 63,000 units, but remained 8.6 percent above the 58,000 unit rate of a year ago. Starts of buildings with 5 or more units slowed by 7.4 percent to a seasonally adjusted annual rate of 390 thousand units, 8.9 percent more than the 358 thousand unit rate of February 1988.

GRAPH 4: IMPROVEMENTS IN THE TRADE DEFICIT STALL



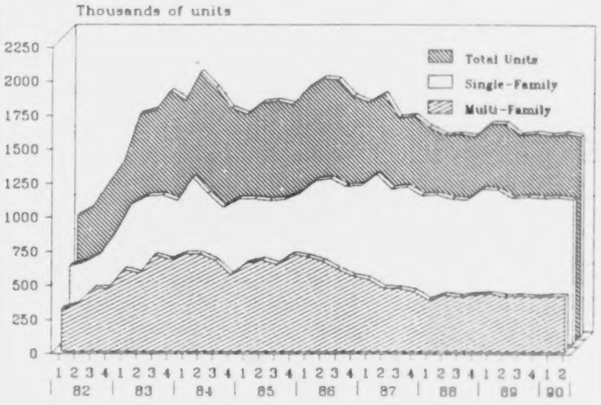
Source: The Federal Reserve Board

GRAPH 5: THE FORECAST FOR LONG-TERM INTEREST RATES



Source: The Federal Reserve Board

GRAPH 6: HOUSING STARTS



Source: The Bureau of Census, E NAR estimates

New Home Sales

Sales of new single-family homes fell to an annual rate of 626 thousand units in February, 9.4 percent below the revised January sales rate of 691 thousand units (originally reported as 704 thousand units), and 4.6 percent below the 656 thousand unit rate of a year ago. The February rate was the lowest in thirteen months, with the overwhelming majority of the drop occurring in the Northeast and in the South. In the Northeast, after rising to a rate of 126 thousand units in January from a low of 65 thousand units during November (a two month increase of 94 percent), sales fell 19.8 percent to a seasonally adjusted annual rate of 101 thousand units. Sales dropped 14.4 percent in the South to an annual rate of 214 thousand units, the slowest rate since January of last year. Midwest sales reached an annual rate of 101 thousand units in February, off 1.0 percent from the January rate of 102 thousand units. In the West, sales slipped 1.4 percent to a seasonally adjusted annual rate of 210 thousand units in February from the January revised rate of 213 thousand units. Relative to February 1988, new home sales were down in the Northeast, Midwest, and the South (by 9.8 percent, 10.6 percent, and 19.6 percent, respectively) but rose 27.3 percent in the West.

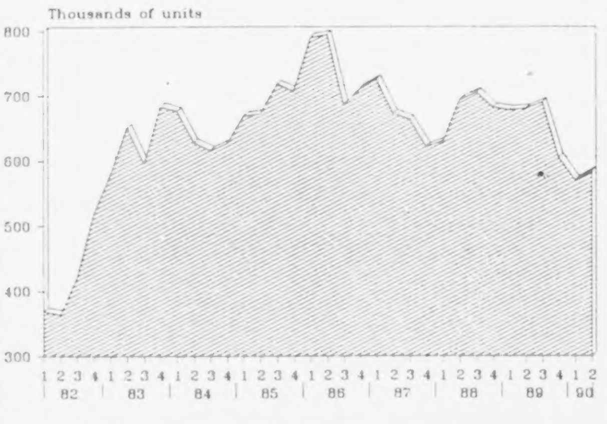
Existing Home Sales

When preliminary estimates of the December 1988 existing single-family home sales rate shot past 4 million units, few analysts expected the housing market to retain that kind of momentum in a time of rising interest rates. The first two months of 1989 have proven this to be true, with sales dropping consecutively for the first time in over a year. Despite the decline, existing single-family homes were sold at the robust annual rate of 3.44 million units in February. This pace was down only 3.1 percent from the January annual rate of 3.55 million units. While the February sales figures were the slowest since the beginning of the last homebuying season in March 1988, they were still 3.6 percent ahead of the February 1988 sales pace. Existing single-family home sales are expected to fluctuate around the 3.4 million to 3.5 million unit range through the 1989 homebuying season. Later in 1989, as economic growth cools down, existing single-family home sales are expected to slow in the fourth quarter to an annual rate of about 3.3 million units.

Home Prices

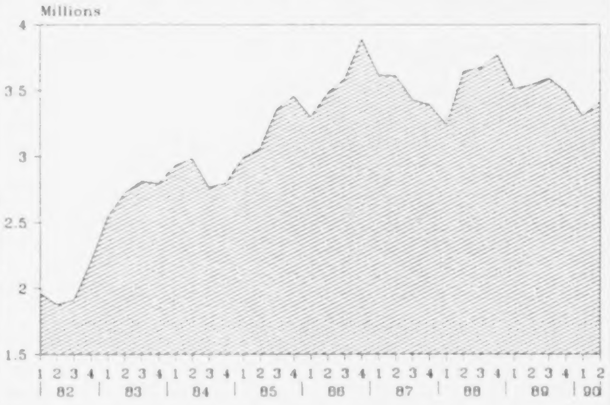
The price of an existing single family home rose 3.8 percent in February to a new high of $93,100. This price is 4.7 percent above the $88,900 median price of one year ago. The large monthly price increase, despite slower sales, could be an early sign that higher interest rates are squeezing out homebuyers in the lower-priced end of the market. A similar situation has been observed from time to time in the market for new homes, where the median price of a new single-family home in February rose 8.9 percent to $123,000, from $113,000 in January. In 1989, both existing and new single-family home prices are expected to continue their excellent record of keeping pace with inflation. The median price for an existing single-family home is expected to increase 5.4 percent in 1989 to $94,100. The median price for a new single-family home is expected to increase 4.9 percent to $118,000 over the course of 1989.

GRAPH 7: NEW HOME SALES



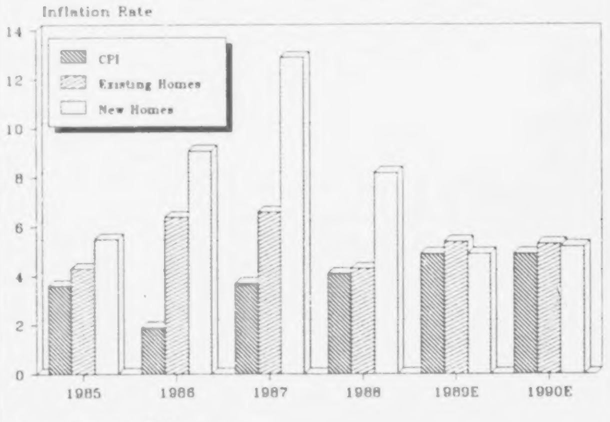
Source: The Bureau of Census; E NAR Estimates

GRAPH 8: EXISTING SINGLE-FAMILY HOME SALES



Source: NAR Economics and Research; E NAR Estimates

GRAPH 9: HOME PRICES



Source: NAR; E NAR Estimates

REGIONAL DATA

Housing Starts

The return of more seasonal weather in February had its greatest effect on housing construction in the Northeast, where starts fell by 22.6 percent to a seasonally adjusted annual rate of 229 thousand units. The drop followed a 47.3 percent increase in January, and left starts 23.7 percent slower than February 1988. Notably, February 1989 marked the 11th consecutive month that housing starts in the Northeast have been slower than the previous year. In the Midwest, housing starts were down 13.7 percent to a seasonally adjusted annual rate of 277 thousand units, but 8.2 percent faster than a year ago. Privately owned homes were started at an annual rate of 400 thousand units in the West, 8.7 percent below the January rate but 10.8 percent faster than the year before. In the South, starts dropped 6.8 percent to a seasonally adjusted annual rate of 592 thousand units, virtually unchanged from the 594 thousand unit rate set in February 1988.

Existing Home Sales

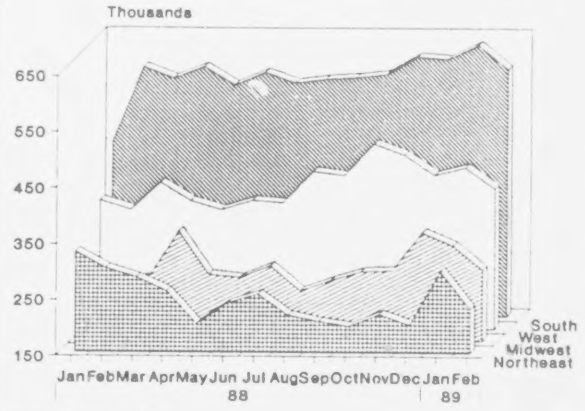
Sales in the Northeast, which managed to remain strong in January despite slowing sales rates throughout the rest of the country, plunged 18.3 percent in February to a seasonally adjusted annual rate of 580 thousand units, 12.1 percent slower than the February 1988 annual rate of 660 thousand units. Sales in the Midwest were off 1.1 percent to a 920 thousand unit pace, but 4.5 percent faster than the February 1988 annual pace of 880 thousand units. February sales in the South reached 1.3 million units, virtually unchanged from the 1.31 million unit rate of January, but up 5.7 percent from the 1.23 million unit pace of February 1988. The West was the only region to post a gain in the rate of existing home sales, where sales rose 3.2 percent in February to a seasonally adjusted annual rate of 650 thousand units, putting the sales rate in the West 20.4 percent above that of a year ago when homes were sold at an annual rate of 540 thousand units.

Home Prices

The median sales price of an existing single-family home located in the South jumped 7.4 percent to $88,500 in February, after rising 5.4 percent in January, in what now appears to be a trend of firming prices in that region. The consecutive monthly rise put home prices in the South at an all time high, and 4.6 percent above the $84,500 median price of a year ago. Prices in the West were up 2.3 percent for the month, and 12.4 percent for the year ending in February at $133,700. In the Midwest, at $69,900, prices were up 3.1 percent from January and 3.9 percent from the year before. Home prices in the Northeast were virtually unchanged at $142,600 (a drop of 0.8 percent), but 3.2 percent higher than one year ago.

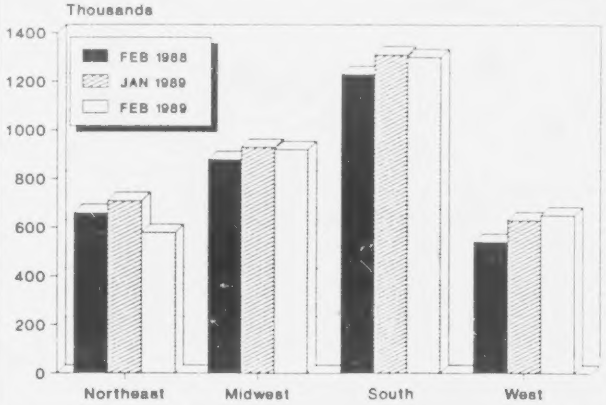
Sean A. Burns
Director of Forecasting
Beth M. Maerz
Research Associate

GRAPH 10: HOUSING STARTS BY REGION



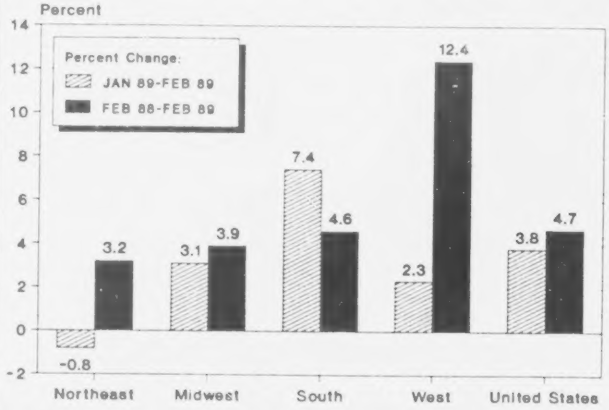
Source: Bureau of Census

GRAPH 11: EXISTING HOME SALES BY REGION



Source: Bureau of Census

GRAPH 12: HOME PRICES BY REGION



Source: NAR Economics and Research

REAL ESTATE AND IMPACTS OF THE CAPITAL GAINS PROPOSAL

The President's Capital Gains Proposal has produced much sensation in the recent weeks since its unveiling. The concepts have been attacked on several fronts: first, the proposal is criticized as giving most of the tax breaks to the very wealthy; second, analysts have widely varying estimates of its revenue impacts, and finally, because certain types of assets and property have been excluded. This article analyzes these issues as they relate to real estate. It is found that while the current proposal is extremely biased in favor of the wealthy, including real estate would reduce the regressivity of the proposal. The controversy over the revenue effects of a capital gains rate reduction is a longstanding one which is yet to be resolved. Moreover, the current proposal would tend to bias investments away from real estate towards financial assets.

DISTRIBUTIONAL ANALYSIS OF CAPITAL GAINS PROPOSAL[1]

Regressive Nature of the Current Capital Gains Proposal:

It is understandable why this capital gains proposal has caused such an uproar. The tables below indicate the extent of the bias in favor of the wealthy. The data presented below are for 1985 from the Federal Reserve Board 1986 Survey of Consumer Finances.[2] Table 1 displays household assets by 3 income classes while Table 2 shows the percent of total assets held by each income class. Table 2 indicates some revealing facts about the regressivity of the proposal:

- The wealthiest 1 percent of the population (those with over $150,000 in income) make 12 percent of total income, and hold a disproportionate amount of total wealth in the form of financial assets. This group holds 45 percent of the bonds and 43 percent of stocks (in $'s), while making 12 percent of total income. Thus, the wealthy hold a disproportionate amount of capital gains producing assets eligible for tax relief under the proposal.

- Households with income between $30,000 and $150,000 make up 33 percent of the population , receive 57 percent of the total income, and hold 38 percent of the bonds and 43 percent of the stocks. Thus, these households own a smaller proportion of stocks, relative to income, than the higher income group.

- Households making incomes less than $30,000 account for 66 percent of the total households, but receive only 31 percent of total income. They hold a disproportionately low amount of financial assets which would benefit from the capital gains proposal. This group holds only 17 percent of total bonds and 14 percent of stocks. Thus, lower income households would not receive very much benefit from the proposal. Their financial assets consist mostly of savings accounts, CD's and IRA's. The President's proposal does include special provisions for lower income households, but these breaks are not terribly meaningful if these taxpayers hold only minimal amounts of stocks.

Table 1
SELECTED HOUSEHOLD ASSETS BY INCOME CLASS
($ MILLIONS)

1985 Total Income From:	To:	Number of Households (000s)	Total Income	Market Value of Home	Market Value of Non-home Real Estate	Bonds	Stocks	Value of Real Estate, Stocks and Bonds
		(1)	(2)	(3)	(4)	(5)	(6)	(7)
0	30,000	56,002	790,329	1,759,074	706,834	73,780	174,787	3,504,804
30,000	150,000	28,044	1,435,583	2,410,116	1,152,203	162,768	531,680	5,692,350
150,000	and over	825	306,456	265,012	354,078	192,978	539,178	1,657,702
Total		84,871	2,532,368	4,434,202	2,213,115	429,526	1,245,645	10,854,856

Source: 1986 Survey of Consumer Finances, Federal Reserve
Condensed version of tabulations by Price-Waterhouse

Table 2
SELECTED HOUSEHOLD ASSETS BY INCOME CLASS
Percent of total, by income class

1985 Total Income From: To:	Number of Households (000s) (1)	Total Income (2)	Market Value of Home (3)	Market Value of Non-home Real Estate (4)	Bonds (5)	Stocks (6)	Value of Real Estate, Stocks and Bonds (7)
0 30,000	65.98%	31.21%	39.67%	31.94%	17.18%	14.03%	32.29%
30,000 150,000	33.04%	56.69%	54.35%	52.06%	37.89%	42.68%	52.94%
150,000 and over	0.97%	12.10%	5.98%	16.00%	44.93%	43.29%	15.27%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Households hold Non-Owner-Occupied Real Estate in proportion to their income:
The proposal excludes certain types of investment real estate from preferential treatment. Under current law, owner-occupied residences are generally protected from capital gains taxation and would be relatively unaffected by the changes. Table 2 (col. 4) indicates that households tend to hold non-home[3] real estate roughly in proportion to their income. Note the following facts illustrated by Table 2:

- Households with income less than 30,000 earn 31 percent of total income and hold 32 percent of non-home real estate.

- Households in the $30,000 to $150,000 income class receive 57 percent of the income and hold 52 percent of non-home real estate.

- The wealthiest group of households, those making over $150,000, receive 12 percent of the income and hold 16 percent of the total non-home real estate.

Thus, the reduction in the capital gains tax for non-home real estate would benefit all households in proportionate to their income.

Including Real Estate in the Proposal Would Help Reduce the Regressivity of the Proposal:
Because such a large proportion of the financial assets proposed to receive preferential treatment are held by the wealthiest 1 percent of households, inclusion of real estate in the proposal cannot totally eliminate its regressivity, but it can help alleviate it substantially. The wealthiest 1 percent of households hold 44 percent of the value of stocks and bonds but only 16 percent of the value of non-home real estate and 6 percent of owner-occupied home value. In contrast, the 66 percent of households making $30,000 or less (who account for 32 percent of total income) hold only 15 percent of the value of stocks and bonds, but own 32 percent of non-home real estate and 40 percent of owner occupied homes (value). Thus, including real estate would help reduce the severity of the regressivity. In fact, Table 2 (col. 8) indicates that households hold the combination of stocks, bonds and real estate (including homes) in about the same proportion as their income.

REVENUE EFFECTS OF THE PROPOSAL

There is also considerable concern about the potential revenue effects of the proposal. Joint Committee on Taxation (JCT) Chief of Staff Ronald A. Pearlman revealed at a recent Senate Finance Committee hearing that capital gains realizations would have to double permanently to avoid losing money under the President's proposal. Pearlman further argued that such an assumption defies historical evidence. In support of the proposal, the Treasury projected a $9.3 billion increase in revenue for fiscal years 1989 through 1994. However, the JCT has estimated that it would lose over $23.9 billion over the same period.

The discrepancy in revenue estimates exist because the effect of tax rate changes on capital gains realization rates are controversial. A tax cut would be expected to reduce revenue if the realizations rate remains the same. However, a reduction in tax rates is expected to increase the frequency of realizations. If realizations increase significantly enough, tax revenue could actually increase due to a tax cut. Studies using different data and methodologies have arrived at opposing conclusions on the effect of a tax reduction for capital gains on revenues. A 1985 Office of Tax Analysis study[4] found that although real estate capital gains realizations are not responsive enough to offset a tax cut, the capital gains tax reductions in the 1978 and 1981 acts both raised revenue. However, an earlier study by Auten[5] found that a capital gains tax rate reduction for real estate would be approximately self financing.

EXCLUSION OF REAL ESTATE AND OTHER ASSETS FROM THE PROPOSAL

The current proposal does not include depreciable and depletable assets such as buildings. However, while buildings will not be eligible for preferential capital gains treatment, land will be eligible. Thus, the proposal as structured in this way encourages low density developments, and discourages investment in real estate relative to financial assets. The proposal also excludes collectibles such as gold coins, jewelry, antiques, etc.

The proposal is purported to encourage long term investment, but in fact is geared towards certain kinds of assets which yield large capital gains (which tends to be riskier). But even here it is being criticized as not meeting its goal of generating increased investments since realized losses are not accounted for. Losses can only be recouped if the investor has offsetting capital gains. The proposal also biases the taxpayer into switching from assets which yield high dividends and low capital gains to assets which yield low dividends and high capital gains - for example, from savings accounts to high risk stocks. Thrift executives are very concerned about the impact of this aspect of the proposal on their industry.

Another justification for the proposal is to "roughly correct for the taxation of purely inflationary gains". However, the proposal, if enacted, would introduce an inequity in the system in that only a fraction of the problem would be corrected. The taxation of inflationary gains resulting from the returns to savings accounts would not be corrected, nor would inflationary gains resulting from returns to investment in human capital - such as education.

by
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1.This analysis is based on the assumption that capital gains are proportional to the value of the assets.

2.Although, they are over three years old it is assumed the relative distribution of ownership has not change significantly.

3.The term "non-home real estate" is used synonymously with "non-owner-occupied real estate".

4.Office of the Secretary of the Treasury, Office of Tax Analysis, Report to Congress on the Capital Gains Tax Reductions of 1978 (September 1985).

5.Gerald E. Auten, "Estimation of the Effects of Capital Gains Taxes on the Realizations of Capital Gains," Final Report on a Project for the Office of Tax Analysis, U.S. Department of the Treasury, October 21, 1981

THE ASSETS OF PROSPECTIVE FIRST-TIME HOMEBUYERS: A LOOK AT THE 1983 AND 1986 SURVEYS OF CONSUMER FINANCES

Previous analysis of the 1983 and 1986 Surveys of Consumer Finances[1] has looked at household wealth and savings,[2] as well as the phenomena of increasing consumer installment debt and the changing types of credit preferred by consumers.[3]

But the uses for the 1983 and 1986 databases are plentiful and many largely untapped. With the increasing burden of high home acquisition costs -- downpayments, mortgage insurance, closing costs, etc., -- REALTORS, homebuilders, mortgage lenders and others in the real estate industry need to determine what resources are available to potential first-time homebuyers for overcoming these hurdles. The 1983 and 1986 Surveys of Consumer Finances can give us a glimpse of the asset portfolios, and other characteristics, of potential first-time homebuyers.

I."Potential" vs. "Prospective First-time Homebuyers"

What constitutes a "potential first-time homebuyer?" All renting households which have never owned their homes have commonly been thought of as "potential first-time homebuyers." Although rising in recent years, according to several surveys the median age of the "first-time homebuyer" remains between 25 and 34 years.[4] Therefore, we will confine our definition of "potential first-time homebuyers" to households which rented in both 1983 and 1986 who are within this age group.

In addition, while all renting households (between 25 and 34) which have never owned are potentially first-time homebuyers, the characteristics of some of them will make homeownership unlikely, at least in the forseeable future. For example, some such households will lack the desire for homeownership and some will have very low incomes. Indeed, the median household income of first-time homebuyers is $36,000.[5] Thus, in order to focus on those who are able to soon make the switch to owning, low income renters should be excluded from the analysis. The implication is that sufficient income is a prerequisite to afford the expenses of owning a home. But asset position is also very important, even if income is sufficient.

The first three columns of Table 1 show average incomes and the income distribution for three groups of 25 to 34 year olds.[6] The table illustrates that there is quite an income differential between the "potential first-time homebuyers" and each of the other young household types. The 1985 household income of our "potential first-time homebuyers" was only 65 percent of that of "first-time homeowners" and only 62 percent of that of young "non first-time homeowners". The income shortfall appears to be applicable to 1983 and 1984 as well. In fact, "first-time homeowners" experienced greater growth in average income between 1984 and 1985 than "potential first-time homebuyers" -- 27 vs. 18 percent.

Table 1 also suggests a disproportionately large share of "potential first-time homebuyers" with 1985 incomes below $20,000. While forty-seven percent of "potential first-time homebuyers" earned 1985 household incomes less than $20,000, only 19 percent of "first-time homeowners" had less than $20,000 in 1985 household income. And an even smaller proportion (15%) of young "non first-time homeowners" had income less than $20,000.

Due to the income disparity, we will further constrain our sample of 25 to 34 year old "potential first-time homebuyers" to those with 1985 household incomes of $20,000 or more. This will be our focus group of "*prospective* first-time homebuyers." We will similarly constrain our "first-time homeowners" and one group of "non first-time homeowners." The last group, "non first-time homeowners" of all ages and incomes, is included in the last column of all the tables for comparison, but will not be discussed.

II. Financial and Real Assets of "Prospective First-time Homebuyers"

The Surveys of Consumer Finances provide us with snapshots of their households' assets. Table 2 shows the percentage of households holding each of 11 asset types in 1986. While all "prospective first-time homebuyers" had checkings and/or savings accounts and most had vehicles, only small shares of them held each of the other asset types. Only one-third of the "prospective first-time homebuyers" had profit sharing and thrift accounts and stocks and mutual funds; while one-quarter or less had IRAs and Keoghs, money market accounts and CDs, life insurance with cash value, bonds and the remaining asset types. (The percentage of "prospective first-time homebuyers" holding IRAs -- 25% or roughly 946,000 households within the population of "prospective first-time homebuyers" --is particularly interesting due to to the proposal to allow tax-exempt withdrawals from IRAs if used as a downpayment on a first home.) Similar results apply to the both groups of young homeowners.

Table 3 shows the median asset value for those who hold the asset. No clear pattern emerges on the assets of "prospective first-time homebuyers" vis-a-vis the assets of comparable homeowners. While both groups of homeowners had greater median values for 7 of the 11 asset types, the differences in many cases were not substantial. Moreover, for "prospective first-time homebuyers", the 1986 median value for IRAs and Keoghs was $4,500, and for profit sharing and thrift accounts was $4,000. These were greater than the same values for the comparable homeowners. The median total asset values (exclusive of current home value) are greater for the comparable homeowners -- $18,396 for "first-time homeowners" and $24,364 for "non first-time homeowners" compared to $15,319 for prospective first-time homebuyers.

Another measure of financial security is pension coverage, particularly 401(k) plans. "Prospective first-time homebuyers'" involvement in such plans should be of particular interest to REALTORS®. Like IRAs, this stems from the ongoing proposal to allow first-time homebuyers to withdraw funds from without tax consequences 401(k)s and similar tax-deferred salary reduction plans for downpayments on homes. Only one-fifth of the "prospective first-time homebuyers" -- or approximately 757,000 households within the population of "prospective first-time homebuyers" -- and only seven percent of their spouses are covered by such plans. This suggests that such a proposal aimed at "prospective first-time homebuyers" would miss a good portion of the target households.

III. Reasons for Household Savings

The reasons for saving among many "prospective first-time homebuyers" strongly suggest that the desire for homeownership still exists for many. Table 4 indicates that the largest percentage (32%) of "prospective first-time homebuyers" were saving primarily to buy their own homes; the second largest percentage (20%) were saving primarily for use in emergencies. This parallels evidence from the renting households (who have never owned a home) from the 1986 National Association of REALTORS Homeownership Survey, one-fifth of whom indicated that their primary reason for saving is for a home downpayment. The only reason cited by a larger percentage (24%) of renters from the NAR Survey as their chief incentive for saving was for use in an emergency.

IV. Conclusion

While the prospect for homeownership is strong for some renting households, there are many who lack the means to overcome the formidable homeownership costs in spite of a strong desire to own. (These costs were discussed in the November 1988 *Real Estate Outlook*, "Explaining Trends in Homeownership".) Faced with declining growth in real income and rising rents in many areas, many renting households are unable to save. Those who are able to save often find that their savings aren't enough because rising home prices caused downpayments and other acquisition costs to soar.

Data from the 1983 and 1986 Surveys of Consumer Finances indicate that many renting households do not hold financial and real assets other than checking and savings accounts and vehicles (whose liquidity is questionable), and this should be kept in mind when strategies to promote homeownership are pondered.

by
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1.The surveys were jointly sponsored by the Board of Governors of the Federal Reserve System and several other government agencies. The 1983 and 1986 Surveys are longitudinally-linked so that households interviewed in 1983 were reinterviewed in 1986, if possible. The Surveys contained questions about household demographics, income and expenditures, balance sheet and mortgage information, employment history and health benefit information, etc. For details, see Robert B. Avery and Gregory E. Elliehausen, Board of Governors of the Federal Reserve System, 1983 Survey of Consumer Finances: Technical Manual and Codebook and the corresponding 1986 manual by Avery and Arthur B. Kennickell.

2.See Robert B. Avery and Arthur B. Kennickell, Board of Governors of the Federal Reserve System, Savings and Wealth: Evidence from the 1986 Survey of Consumer Finances, prepared for a conference on research in income and wealth, NBER, May 1988.

3.See Robert B. Avery, Gregory E. Elliehausen and Arthur B. Kennickell, "Changes in Consumer Installment Debt: Evidence from the 1983 and 1986 Surveys of Consumer Finances," Federal Reserve Bulletin, October 1987.

4.For a comprehensive discussion of the characteristics of first-time homebuyers, see John Simonson, Prospective First-time Homebuyers: Salient Characteristics and Their Implications, report prepared for the National Association of REALTORS, February 1989.

5.Information on first-time homebuyers and financing methods from the NAR Spring 1988 Residential Mortgage Finance Survey.

6.Since there is no way in which to discern household tenure either before 1983 or between 1983 and 1986, we will make some assumptions. First, it is highly probable that households between 25 and 34 which rented in both 1983 and 1986 have never owned. Therefore, we will assume such and consider this group "potential first-time homebuyers." Second, it is plausible that households which rented in 1983 and owned in 1986 between 25 and 34 are "first-time homeowners" and we will assume such. Third, for households which owned their homes in both 1983 and 1986, we will assume that they are "non first-time homeowners" although this may be erroneous in some cases.

Table 1

Household Incomes
Average value for:

	Potential First-Time Homebuyers (ages 25-34)	First-Time, Homeowners (ages 25-34)	Non First-Time Homeowners (ages 25-34)	Non First-Time Homeowners (all ages)
1985 Incomes	$22,288	$34,321	$36,184	$102,315
1984 Incomes	18,922	27,038	31,242	95,690
1983 Incomes	16,357	23,166	27,900	83,855
Percent of households earning 1985 income:				
Less than $10,000	15.0%	4.2%	3.2%	11.6%
$10,000 - 19,999	31.6	15.1	12.2	16.3
$20,000 - 29,999	25.7	26.9	23.9	15.6
$30,000 - 39,999	18.2	18.5	28.4	13.4
$40,000 - 49,999	5.9	16.8	14.4	10.4
$50,000 +	3.7	18.5	18.0	32.7

Source: 1986 Survey of Consumer Finances, Federal Reserve Board.

Table 2

1986 Financial and Real Assets

Percent of households
holding assets in 1986:

	Prospective First-Time Homebuyers	First-Time Homeowners	Non First-Time Homeowners	Non First-Time Homeowners (all ages & incomes)
Stocks and Mutual Funds	30.0%	20.8%	19.1%	34.4%
Bonds	21.0	30.2	33.5	33.6
Checking and Savings Accounts	100.0	97.9	98.9	96.4
IRA's and Keoghs	25.0	30.2	30.3	42.0
Money Market Accts and CD's	25.0	24.0	26.1	42.9
Profit Sharing and Thrift Accts.	31.0	29.2	31.0	20.1
Life Insurance, Cash Value	25.0	34.4	43.1	47.8
Other Financial Assets	1.0	2.1	4.3	12.3
Real Estate, other than Primary Residence	12.0	13.5	19.1	35.2
Business Assets	6.0	12.5	18.1	25.1
Vehicles	91.0	99.0	100.0	93.9

Source: 1986 Survey of Consumer Finances, Federal Reserve Board.

Table 3

1986 Financial and Real Assets

Median 1986 dollar values* for:

	Prospective First-Time Homebuyers	First-Time Homeowners	Non First-Time Homeowners	Non First-Time Homeowners (all ages & incomes)
Stocks and Mutual Funds	$1,100	$2,300	$2,000	$28,719
Bonds	150	500	500	7,600
Checking and Savings Accts.	1,950	2,000	2,250	4,000
IRA and Keogh Accts.	4,500	3,500	3,000	12,000
Money Market Accounts and CD's	5,000	3,100	7,000	21,000
Profit Sharing and Thrift Accounts	4,000	1,950	3,000	15,000
Life Insurance, Cash Value	1,862	2,345	3,500	5,091
Other Financial Assets	2,000	16,900	7,500	80,000
Real Estate, other than Primary Residence	25,533	30,000	29,000	100,000
Business Assets	1,114	4,221	19,332	105,000
Vehicles	6,000	7,702	7,315	8,420
Total Assets**	15,319	18,396	24,364	54,010

* Median values are based only on the households holding these assets. Because such a small percentage of households hold certain assets, the median values are sometimes based on a very small number of households.

** This does not include the current value of primary residences, whose inclusion would substantially increase the total value of assets of the homeowners.

Source: 1986 Survey of Consumer Finances, Federal Reserve Board.

Table 4

Reasons for Saving of "Prospective First-Time Homebuyers"

Percent of households indicating as:

	First reason	Second reason	Third reason
To buy own house	32.0%	10.0%	1.0%
Emergencies, "rainy days," other unexpected needs; for security	20.0	10.0	8.0
For retirement/old age	8.0	9.0	1.0
To get ahead; for the future; to advance standard of living	8.0	1.0	4.0
To buy durable household goods, appliances, home furnishings; hobby items; other purchases	8.0	5.0	4.0
Investment reasons, e.g. to receive interest, to diversify, to invest	5.0	4.0	2.0
To travel/take vacations	4.0	7.0	2.0
Reserves in case of unemployment	0.0	4.0	1.0
To help kids out; for the family; to have children/baby	3.0	4.0	2.0
For children's (grandchildren's) education	2.0	5.0	1.0
Inappropriate (second and third reasons only)	0.0	28.0	69.0
Don't/can't save (first reason only)	1.0	0.0	0.0
Other	9.0	13.0	5.0

Source: 1986 Survey of Consumer Finances, Federal Reserve Board.

U.S. ECONOMIC OUTLOOK

APRIL 1989

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL			FORECAST	
	88.3	88.4	89.1	89.2	89.3	89.4	90.1	90.2	1986	1987	1988	1989	1990
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4909	5000	5108	5187	5263	5337	5422	5497	4240	4527	4864	5224	5537
% Change	7.3	7.6	8.9	6.4	6.0	5.7	6.6	5.6	5.6	6.8	7.5	7.4	6.0
% Change (w/out inflation)	2.5	2.4	5.0	2.5	2.0	1.9	2.0	1.5	2.8	3.4	3.9	3.0	1.9
Consumer Price Inflation (CPI)	4.8	4.4	5.3	5.0	4.6	4.6	5.2	5.1	1.9	3.7	4.1	4.9	4.9
GNP Inflation (GNP Deflator)	4.7	5.3	3.6	3.8	3.8	3.8	4.5	4.0	2.7	3.3	3.4	4.2	4.1
Unemployment Rate - Civilian	5.5	5.3	5.3	5.3	5.2	5.2	5.2	5.4	7.0	6.2	5.5	5.2	5.4
Civilian Employment-Household Basis (millions)	115.2	115.8	116.9	117.5	118.0	118.4	118.8	119.0	109.6	112.4	115.0	117.7	119.2
Percent change	2.0	2.2	3.9	1.8	1.7	1.5	1.2	0.8	2.3	2.6	2.3	2.4	1.2
Index of Industrial Production	138.4	139.9	141.2	142.3	142.8	143.4	144.0	144.3	125.1	129.8	137.2	142.4	144.5
Manufacturing Capacity Utilization	84.0	84.4	84.8	85.3	85.2	84.9	84.9	84.8	79.7	81.0	83.6	85.1	84.5
Domestic Auto Sales	7.6	7.5	7.0	7.2	7.2	7.2	7.2	7.2	8.2	7.1	7.5	7.2	7.2
Federal Tax Receipts (NIPA) as % of GNP	19.9	19.8	20.0	20.3	20.4	20.4	20.9	20.8	19.5	20.2	20.0	20.3	20.8
Federal Expenditures (NIPA) as % of GNP	22.4	23.0	23.0	22.9	22.9	22.9	23.0	23.0	24.4	23.7	23.0	22.9	23.1
Deficit(NIPA)	-123.5	-157.8	-151.4	-132.6	-131.1	-129.6	-118.3	-122.3	-205.6	-157.8	-142.4	-136.2	-124.3
as % of GNP	-2.5	-3.2	-3.0	-2.6	-2.5	-2.4	-2.2	-2.2	-4.9	-3.5	-2.9	-2.6	-2.2
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4692	4874	4607	4578	4638	4529	4349	4441	4712	4648	4651	4588	4386
Percent change – year ago	3.6	9.6	-2.0	-2.0	-1.1	-7.1	-5.6	-3.0	10.6	-1.4	0.1	-1.3	-4.4
Existing Single-family Home Sales (thousands)	3663	3770	3510	3540	3590	3490	3305	3410	3565	3526	3594	3533	3347
Percent change – year ago	6.8	11.2	6.4	-2.8	-2.0	-7.4	-5.8	-3.7	10.9	-1.1	1.9	-1.7	-5.3
Housing Starts (thousands)	1467	1559	1560	1477	1492	1476	1486	1471	1812	1634	1496	1501	1481
Percent change – year ago	-9.4	1.7	5.6	-0.2	1.7	-5.3	-4.7	-0.4	4.1	-9.8	-8.5	0.4	-1.3
Single-Family Units	1061	1138	1131	1070	1081	1072	1076	1062	1183	1157	1089	1088	1071
Percent change – year ago	-8.1	4.5	3.2	0.8	1.9	-5.9	-4.9	-0.7	10.4	-2.2	-5.8	-0.1	-1.6
Multi-Family Units	406	420	428	407	412	404	410	409	630	477	406	413	410
2-4 Family Units	57	65	67	63	64	63	64	64	85	66	59	64	64
Percent change – year ago	3.0	16.0	18.1	10.4	12.2	-3.8	-4.3	0.3	-9.0	-22.6	-10.3	8.7	-0.7
5 + Family Units	349	355	362	344	348	342	346	345	545	412	347	349	346
Percent change – year ago	-14.7	-8.2	11.7	-4.7	-0.4	-3.8	-4.3	0.3	-5.6	-24.4	-15.7	0.4	-0.7
New Single-family Home Sales (thousands)	703	682	670	680	690	605	570	585	750	671	677	663	585
Percent change – year ago	4.1	9.8	7.6	-2.4	-1.8	-11.3	-15.9	-14.0	9.0	-10.5	0.9	-2.0	-11.8
Mobile Homes Shipped (thousands)	218	223	240	238	245	243	244	241	246	233	217	241	244
HOME PRICES													
Existing Home Prices - Median $(1000)	90.2	88.7	92.1	93.8	95.1	95.6	96.7	98.1	80.3	85.6	89.3	94.1	99.1
Percent change – year ago	5.5	4.4	4.9	5.5	5.4	7.8	5.0	4.6	6.4	6.6	4.3	5.4	5.3
New Home Prices - Median $(1000)	114.9	114.9	115.3	117.5	119.0	120.2	120.9	123.4	92.0	104.0	112.5	118.0	124.1
Percent change – year ago	8.2	2.8	2.1	4.0	3.6	4.6	4.9	5.0	9.1	12.9	8.2	4.9	5.2
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.7	10.6	10.9	11.2	11.1	10.8	10.7	10.6	9.9	10.2	10.5	11.0	10.6
1-year ARM (without buydown)	8.3	8.5	8.8	9.1	8.9	8.7	8.6	8.5	9.5	8.5	8.5	8.9	8.5
Corporate AAA Bond Rate	10.0	9.5	9.7	10.2	10.0	9.9	9.7	9.7	9.0	9.4	9.7	10.0	9.9
Government Bond Rate	9.2	9.0	9.0	9.4	9.3	9.1	9.0	9.0	7.8	8.6	9.0	9.2	9.0
Short-Term Interest Rates													
Federal Funds Rate	8.0	8.5	9.5	10.0	9.8	9.5	9.0	8.8	6.8	6.7	7.6	9.7	8.8
3-month T-Bill Rate	7.0	7.7	8.4	9.3	9.1	8.7	8.4	8.1	6.0	5.8	6.7	8.9	8.1
Prime Rate	9.7	10.2	10.9	11.8	11.6	11.2	10.8	10.4	8.3	8.2	9.3	11.4	10.4
Discount Rate	6.3	6.5	6.7	7.0	7.1	7.1	7.0	6.8	6.3	5.7	6.2	7.0	6.8
Value of the U.S. Dollar (Trade-Weighted Avg.)	97.6	93.0	96.3	96.4	92.5	89.5	87.7	85.7	112.3	96.9	92.8	93.7	86.3
Percent change	35.6	-17.6	15.1	0.7	-15.5	-12.0	-8.1	-8.7	-21.6	-13.6	-4.3	1.0	-7.9

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz.

EQUAL HOUSING
OPPORTUNITY

A7000-1
6/6/89

REAL ESTATE OUTLOOK

Vol. 2, No. 5

May 1989

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- According to the U.S. Department of Commerce, real GNP expanded at an annual rate of 5.5 percent in the first quarter of 1989, the fastest rate of growth since the fourth quarter of 1987. Non-farm real GNP growth grew at an annual rate of 3.0 percent, down from 3.5 percent in the fourth quarter of 1988.
- Consumption growth slowed in the first quarter due to a growing apprehension towards borrowing on the part of the consumer. This has translated into a large drop in consumer spending on big-ticket items, especially for automobiles and light trucks.
- In the first 3 months of 1989, the personal savings rate has skyrocketed, jumping to a four year high in March of 6.3 percent.
- The GNP price index (fixed weights) rose 5.0 percent in the first quarter, while the consumer price index rose at an annual rate of 6.3 percent from December 1988 to March 1989.
- In just two months, housing starts have fallen 16.7 percent to an annual rate of 1.397 million units. Single-family units alone fell 17.1 percent over the course of February and March to the slowest rate since January of 1985.
- Sales of new single-family homes fell for the second consecutive month in March to a seasonally adjusted annual rate of 587 thousand units. The combined two month fall left home sales 15.4 percent lower than the January annual rate of 694 thousand units.
- Existing single-family home sales dropped 4.3 percent in March to a seasonally adjusted annual rate of 3.33 million units. In the first quarter of 1989, existing home sales reached an annual rate of 3.45 million units, down 8.5 percent from the 1988 fourth quarter rate of 3.77 million units.
- The latest 1.3 percent increase in the median price of an existing single-family home marked the fourth consecutive monthly rise, boosting the median sales price of an existing home to an all-time high of $93,100 in March.

IN THIS ISSUE

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THE ARISTOTELIAN ECONOMY
Economic Commentary

by
John A. Tuccillo
Chief Economist and
Senior Vice President
Real Estate Finance

For the mean-spirited and curmudgeonly in the economics and finance community, it could be the worst of times. Since November of 1987--fully nineteen months--cries and alarms of recession, skyrocketing interest rates and hyperinflation have filled the newspages and the airways. But, at every single turning point the economy failed to go off the deep end, but rather returned to this monotonous path of modest growth and moderate interest rates that it has followed since 1982.

The most recent example has been the interest rate rise generated by the Federal Reserve over the past year, in an attempt to slow down the economy. Yes, rates have risen; yes, inflation is up a bit. But in neither case is disaster evident, as both rates are peaking out well short of their feared potential. In fact, the Fed is just about ready to strike the flag, declare the battle won, and withdraw in orderly fashion to pursue other pressing issues.

Why? How come this economy is reaching the edge of the abyss and then pulling itself back before plunging in, as it did so often during the Seventies? Economists ascribe this behavior to the phenomenon of "rational expectations." Quite simply (an oxymoron when juxtaposed with any economic theory), information about the shape of coming events is so widely known that economic agents act as if the events have happened and thus blunt their impact. Or, as the Lord High Executioner Ko-ko explains in the final scene of "The Mikado" in an effort to save his neck, "When your majesty orders a thing done, it's as good as done. And as this is so, why bother doing the thing at all?"

More practically, information technology has advanced to the stage where financial markets operate with an efficiency previously undreamed. They anticipate both economic events and economic policy and move to profit from this anticipation. When that occurs, the effect of the event becomes less. Thus, if the market perceives that the Fed is pushing rates up it will sell off long term securities producing the result desired by policy more quickly and efficiently. Consequently, the ultimate goal of policy--the slowing of the economy --is achieved with a smaller rise in rates than anticipated. This growing sophistication in financial markets combined with an older and more productive labor force has been the key to the run of moderate prosperity we have seen in this economy.

Does this mean that business cycles are no more? Hardly, steady growth has occurred in an environment where policy makers and the public are unwilling to come to grips with a major weakness in the economy that could in fact bring down the house. During this run of economic splendor, we have exalted profligacy over thrift both personally and publicly. Sharply higher public and private debt suggest we are modelling ourselves after a line from Richard Penniman (aka Little Richard), "I don't care how I spend my gold, tonight I'll be one happy soul." Moreover, the recent budget agreement between the Administration and the Congress is more smoke and mirrors, rather than a serious effort to deal with a serious problem.

There is a theory that a continuing budget deficit is good discipline in that it prevents any interest rate or inflation surges that will pop the budget balloon. While this is a little like suggesting that cancer is good because it forces you to eat right, it still represents yet another potential source of moderating tendencies in this economy. Of course, without the deficit, we would still have an essentially self-correcting economy, but interest rates and inflation might well be lower.

Although my many years of Jesuit Training developed in me a respect for great ideas, I've always found more sense in Aristotle's counsel toward moderation than in the extremism of Plato. What we have seen over the past seven years is the economic equivalent of that approach to life. For a variety of reasons, we have become very much an Aristotelian economy, where the golden mean is the common state of affairs. In the long run, this moderation is healthier for the economy, can accommodate the kinds of long-term demographic and geopolitical changes we are facing and will allow us to sustain growth longer. And moderation is an ideal that I, for one, will defend to my last drop of blood!

Outlook for the Economy and Real Estate

ECONOMIC OUTLOOK

According to the U.S. Department of Commerce, real GNP expanded at an annual rate of 5.5 percent in the first quarter of 1989, the fastest rate of growth since the fourth quarter of 1987, when growth was 6.1 percent. However, a substantial part of this growth rate is a 2.5 percentage point drought-related adjustment factored in by Commerce Department economists. Most of this adjustment fell into the category of farm inventory investment, as farmers are expected to replenish inventories depleted during the 1988 drought. Netting out this drought adjustment, non-farm real GNP growth (the rate which most analysts, including those at the Federal Reserve, are concerned with) grew at an annual rate of 3.0 percent, down from 3.5 percent in the fourth quarter of 1988. While the present slowdown may be more gradual than the monetary authority would have preferred, the Fed is most likely pleased with this report and other, more recent, evidence that the economy is slowing down. Many of the March indicators bear witness to this economic retreat, with housing starts and home sales falling, capacity utilization retreating, and retail sales and durable goods orders growing modestly after months of decline. This trend of modestly slower growth is expected to continue in the coming months, as real GNP growth slows to 2.2 percent in both the second and third quarters, and 1.8 percent in the fourth.

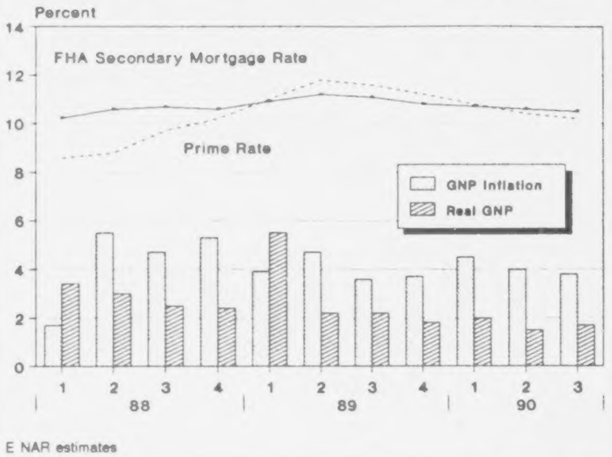
Consumption Growth Slows

A closer look at the composition of GNP growth reveals an encouraging change: voracious consumer spending yielding to stronger business fixed investment and net export growth. This sign of slowing growth in consumer demand could be the pause that refreshes the nation's overburdened factories, relieving the trend towards rising prices. Less capacity devoted to domestic consumption goods could allow for increased production of exported goods, which would help trim the trade deficit. Another positive indicator in the GNP report was accelerated business outlays on structures and equipment, which generally fall during times of high interest rates. By escalating fixed investment, businesses are laying the foundation necessary for future increases in productivity. This in turn enhances U.S. firms' ability to compete with foreign firms, and reduces the chances of future capacity shortages and bottlenecks.

Autos Become a Hard Sell

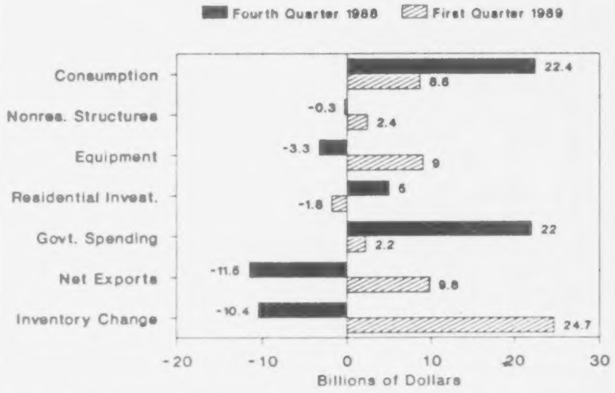
The consumption slowdown of the first quarter was fueled mainly by growing apprehension towards borrowing on the part of the consumer. This has translated into a large drop in consumer spending on big-ticket items, especially for automobiles and light trucks. Between December 1988, and March 1989, sales of domestic autos fell 21.0 percent from a seasonally adjusted annual rate of 8.4 million to 6.6 million cars. During the first 10 days of April, car dealers managed to raise the sales rate to 7.6 million units (about level with the sales rate set last April), but only after offering expensive rebate programs and cut rate financing (as low as 0.0 percent in some cases). The outlook for car sales through the rest of 1989 is mixed, as high interest rates may force the auto companies to continue these expensive incentive programs; programs which have a tendency to borrow from future auto sales rates.

GRAPH 1: THE ECONOMIC OUTLOOK



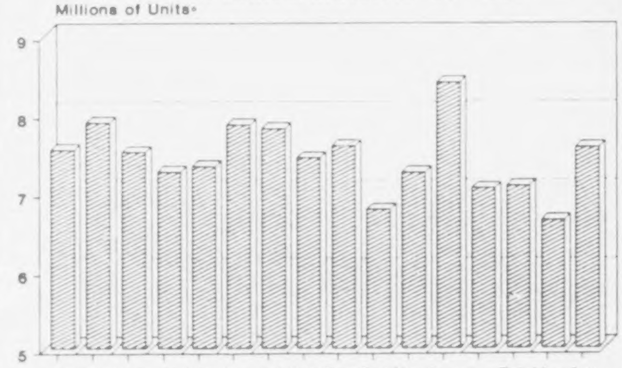
E NAR estimates

GRAPH 2: THE COMPOSITION OF REAL GNP GROWTH



Source The Department of Commerce

GRAPH 3: AUTO SALES ARE SLUGGISH IN THE OPENING MONTHS OF 1989



*Seasonally adjusted annual rates
Note The Apr 89 rate is based on the first 10 days of April
Source The Bureau of Economic Analysis

Saving Is Back In Style

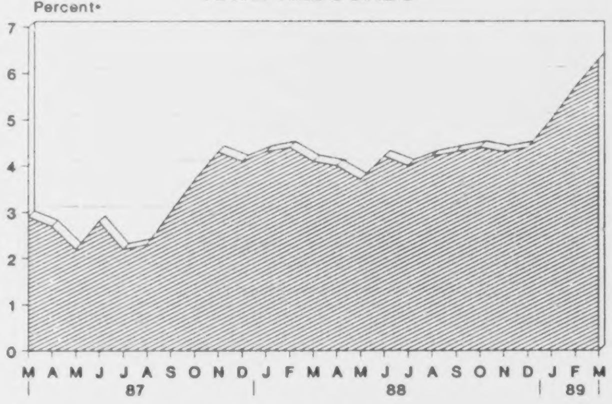
The recent slowdown in consumer spending has cast doubt on the now familiar argument that Americans have forgotten how to save. Concerns surrounding this country's diminishing rate of savings peaked in May of 1987, when the savings rate (savings as a percent of disposable income) fell to an all time low of 2.2 percent. Savings made a gradual comeback during the remainder of 1987, and by 1988 the rate had reached 4.0 percent. However, in the first 3 months of 1989, personal savings have skyrocketed, jumping to a four year high in March at a rate of 6.3 percent. Rising interest rates, which have slowed the demand for big-ticket consumer durables like automobiles, have in turn encouraged savings. Moreover, many analysts point out that the leading edge of the baby boom generation, which fueled the consumption splurge of the past decade, has reached the age of higher income and saving rates. If true, this could mean that a higher level of thrift resembling historical patterns is coming back into vogue. Of course, one quarter's data is too brief to mark the beginning of such a change. However, a higher portion of income devoted to saving would go a long way to helping cure some economic problems: aid the long process of adjusting the trade imbalance and reduce reliance on foreign capital to fund the domestic budget deficit.

So far, 1989 has been a year of surprising economic growth that now appears to be yielding to a slower, more sustainable pace. Seven years of economic expansion have built up significant capacity constraints, a greater potential for wage escalation, and as a result, a generally higher level of producer and consumer prices. Most recently, the GNP price index (fixed weights) rose 5.0 percent in the first quarter, while the consumer price index rose at an annual rate of 6.3 percent from December 1988 to March 1989. It is fairly common for prices to continue rising after the economy begins to slow, as it can take several months of slow growth for the bottlenecks and shortages, which contributed to the faster rates of inflation, to subside. Therefore, we should not expect prices to turn downwards as soon as the pace of economic growth slows. Rather, we expect to see some relief in prices late this summer, provided there are no unexpected shocks to the economy, such as a repeat of the 1988 drought or a surge in energy prices.

MONETARY POLICY AND INTEREST RATES

The rising rate of inflation has raised concerns that the Fed may need to squeeze credit a bit more and nudge interest rates higher in order to further slow economic growth. However, given the number of recent monthly indicators that suggest the economy has slowed more than the GNP report indicates, the Fed is believed to be sitting tight, waiting for more information on the economy's course. In this enviornment, short-term rates have drifted lower in the past month, allowing the yield curve to flatten somewhat. However, short-term rates have not fallen below the yield on long-term government bonds, leaving the yield curve inverted. If the popular economic barometers continue to suggest a slowdown in real GNP growth to the 2.0 to 2.5 percent range, interest rates are expected to follow suit. We believe that interest rates are now close to what will likely be their highest levels in 1989, and we expect them to fall noticeably by the summer's end.

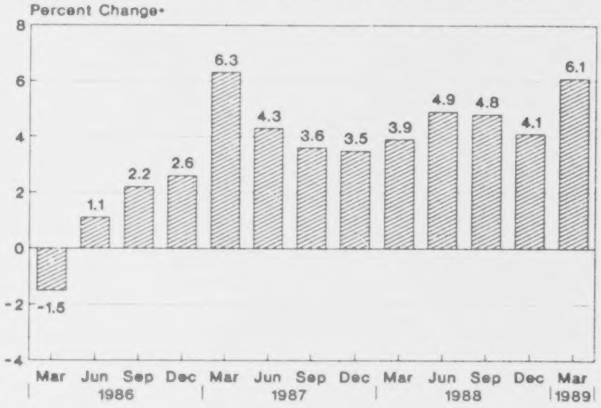
GRAPH 4: THE PERSONAL SAVINGS RATE REBOUNDS



*Savings as a Percent of Disposable Income

Source: The Bureau of Economic Analysis.

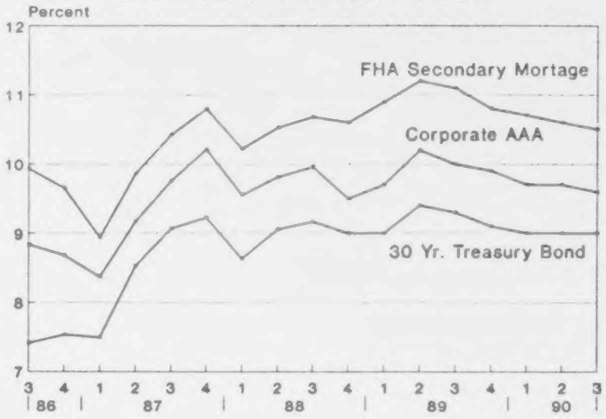
GRAPH 5: INFLATION PICKS UP SPEED



*Seasonally Adjusted Annual Rate

Source: The Bureau of Labor Statistics.

GRAPH 6: THE FORECAST FOR LONG-TERM INTEREST RATES



Source: The Federal Reserve Board.

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

		Total	S-F	2-4	5 and up
Mar	1989	1397	994	48	355
Feb	1989	1476	1034	56	386
Jan	1989	1678	1199	66	413
Dec	1988	1577	1141	65	371
Mar	1988	1528	1169	57	302

March 1989
Percent
Change From:

		Total	S-F	2-4	5 and up
Feb	1989	-5.4%	-3.9%	-14.3%	-8.0%
Mar	1988	-8.6%	-15.0%	-15.8%	17.6%

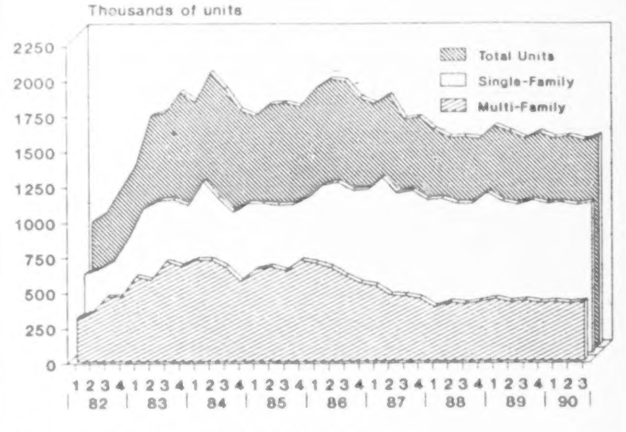
		Northeast	Midwest	South	West
Mar	1989	149	307	546	395
Feb	1989	226	278	573	399
Jan	1989	293	313	642	430
Dec	1988	210	343	609	424
Mar	1988	284	261	574	409

March 1989
Percent
Change From:

		Northeast	Midwest	South	West
Feb	1989	-34.1%	10.4%	-4.7%	-1.0%
Mar	1988	-47.5%	17.6%	-4.9%	-3.4%

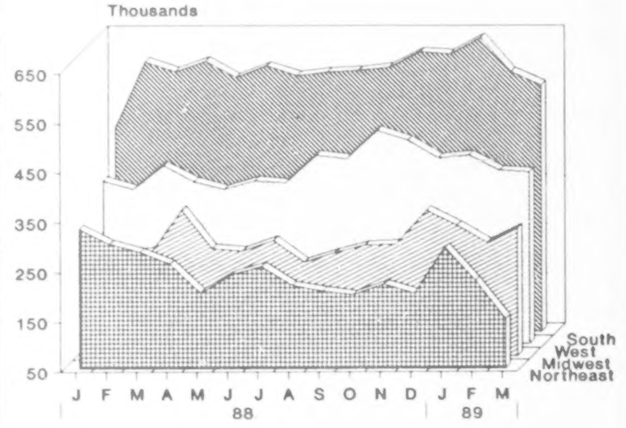
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: The Bureau of Census; E NAR Estimates

GRAPH 8: HOUSING STARTS BY REGION



Source: The Bureau of Census

In the past two months housing starts have proven the old cliche (as well as the law of gravity) that what goes up must come down. When housing starts began their climb back in September of 1988, which culminated in January 1989 at a 16 month high, most analysts stepped back and waited for the fall. In just two months, housing starts have fallen 16.7 percent to an annual rate of 1.397 million units. Single-family units alone fell 17.1 percent over the course of February and March to the slowest rate since January of 1985. It seems that higher mortgage rates, particularly higher rates on adjustable mortgages, have put a damper on housing activity. The good news is that further interest rates increases, if any, are expected to be modest. However, slower economic growth is expected for the remainder of this year and into 1990. This slowdown in growth should moderate housing activity into 1990, with starts totaling 1.475 million units this year and 1.492 million units in 1990.

As the table above shows, the recent fall in housing starts has not been shared evenly throughout the four regions. Rather, much of the construction slowdown has occurred in the Northeast, where March housing starts hit their lowest rate since September of 1983. The South has also seen starts trend downward over the past few months, falling to their slowest rate in more than a year. Meanwhile, starts in the West remain strong at an annual rate of 395 thousand units. In the Midwest, starts increased by 10.4 percent in March to an annual rate of 307 thousand units, a gain of 17.6 percent over March 1988.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Mar 1989	587	Aug 1988	555
Feb 1989	621	Jul 1988	691
Jan 1989	694	Jun 1988	712
Dec 1988	674	May 1988	701
Nov 1988	650	Apr 1988	716
Oct 1988	718	Mar 1988	679
Sep 1988	691		

Mar 1989 Changes From:		Annual Totals:	
Feb 1989	-5.5%	1987	671
Mar 1988	-11.7%	1988	677

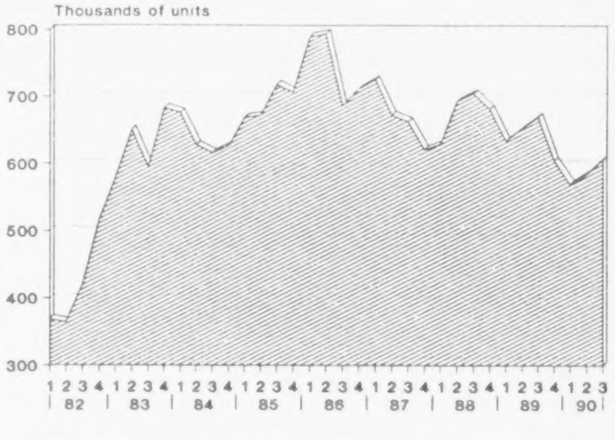
REGIONAL DATA

	Northeast	Midwest	South	West
Mar 1989	129	105	199	155
Feb 1989	90	108	228	190
Jan 1989	123	103	261	207
Dec 1988	112	93	263	206
Nov 1988	65	104	254	227
Oct 1988	96	111	274	238
Feb 1988	114	90	282	180
1988	102	97	275	202
1987	134	102	288	140

Mar 89 Changes From:				
Feb 1989	43.3%	-2.8%	-12.7%	-18.4%
Mar 1988	13.2%	16.7%	-29.4%	-13.9%

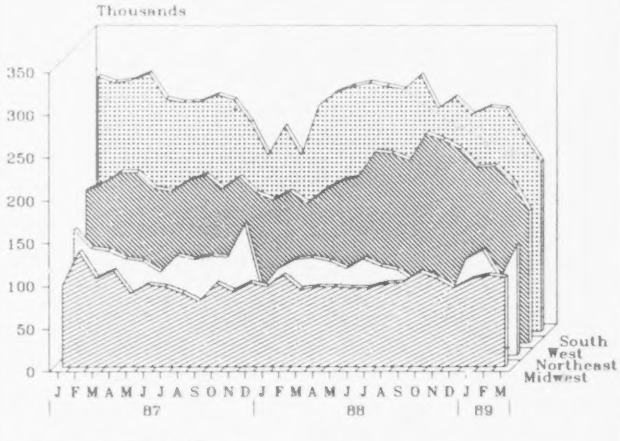
Source: Bureau of the Census, Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: The Bureau of Census; E NAR Estimates

GRAPH 10: NEW HOME SALES BY REGION



Source: The Bureau of Census

Sales of new single-family homes fell for the second consecutive month in March to a seasonally adjusted annual rate of 587 thousand units. The combined two month fall left home sales 15.4 percent lower than the January annual rate of 694 thousand units. Setting annual rates aside, 163 thousand new homes were sold in the first quarter of 1989, almost even with the 1988 first quarter total of 166 thousand units.

Regionally, new home sales appear to have changed dramatically in March. However, government analysts warn against reading too much into one month's figures due to the large margins of error accorded any individual statistic. The two regions to register the greatest losses in March were the South and the West. The South reported a 12.7 percent decline to an annual rate of 199 thousand units, the lowest annual rate since July 1982. Sales in the West dropped 18.4 percent to an annual rate of 155 thousand units. In recent months, new home sales in the West have shown a trend towards softening. However, the March sales rate is considered to be unrealistically low and sales are expected to return to a higher level in April. Even more surprising than the tumble in the West was the 43.3 percent sales increase in the Northeast, where the housing market has been struggling for some time. The 129 thousand unit annual rate was the fastest rate in the Northeast since January 1987. As for the Midwest, with an annual sales rate of 105 thousand units in March (down 2.8 percent from February), new home sales have remained strikingly stable during 1989, particularly when compared to the erratic behavior of home sales in the other three regions.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Mar 1989	3330	Aug 1988	3690
Feb 1989	3480	Jul 1988	3650
Jan 1989	3550	Jun 1988	3800
Dec 1988	3920	May 1988	3620
Nov 1988	3710	Apr 1988	3510
Oct 1988	3680	Mar 1988	3382
Sep 1988	3650		

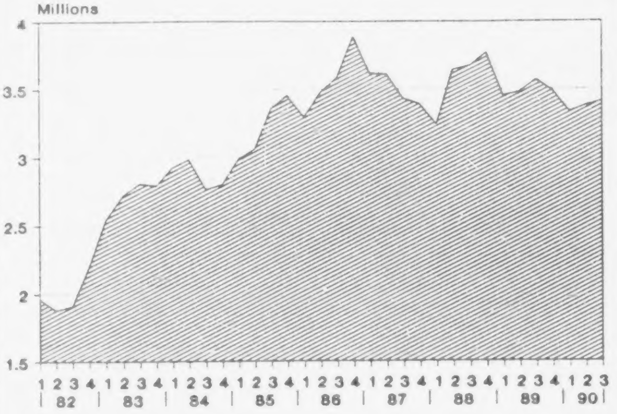
Mar 1989 Changes From:		Annual Totals:	
Feb 1989	-4.3%	1988	3594
Mar 1988	-1.5%	1987	3526

REGIONAL DATA

	Northeast	Midwest	South	West
Mar 1989	540	850	1270	670
Feb 1989	600	920	1310	640
Jan 1989	710	930	1310	630
Dec 1988	700	1010	1500	700
Nov 1988	680	940	1410	680
Oct 1988	640	940	1410	690
Mar 1988	650	870	1270	600
1988	673	929	1350	642
1987	685	959	1282	600
Mar 1989 Changes From:				
Feb 1989	-10.0%	-7.6%	-3.0%	4.7%
Mar 1988	-16.9%	-2.3%	0.0%	11.7%

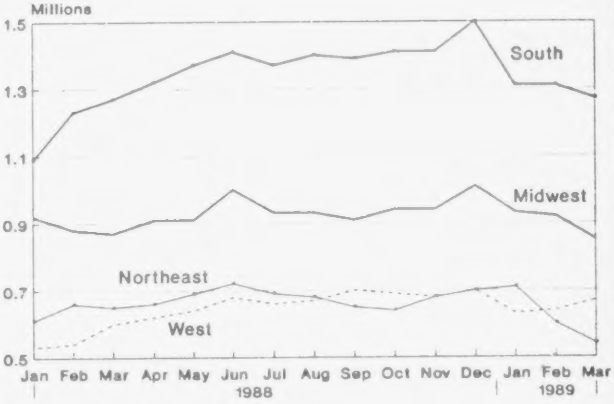
Source: NATIONAL ASSOCIATION OF REALTORS®, Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: The Bureau of Census; E NAR Estimates

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics and Research; E NAR Estimates

Sales of existing single-family homes fell 4.3 percent in March to a seasonally adjusted annual rate of 3.33 million units, putting existing home sales at their slowest rate since February of last year, when homes were sold at an annual rate of 3.32 million units. In the first quarter of 1989, existing home sales reached an annual rate of 3.45 million units, down 8.5 percent from the 1988 fourth quarter rate of 3.77 million units, but up 4.6 percent from the first quarter of 1988. The strong finish to 1988 all but guaranteed a slower opening to 1989. However, the forecasted decline in interest rates during the summer months (due to generally slower economic growth) is expected to bolster existing single-family home sales. In fact, we forsee existing home sales remaining fairly stable through the current selling season, reaching an estimated annual rate of 3.48 million homes during the second quarter, and an estimated 3.5 million homes sold for all of 1989.

The March slowdown in existing home sales was shared by three of the four regions; unlike the February decline which was centered in the Northeast. Only the West posted a gain, where sales are rebounding from a 10.0 percent drop in January. As with housing starts, the real soft spot in existing home sales is the Northeast, where sales have fallen by 23.9 percent over the past two months. Sales could continue to fall in this region until prices, which have remained surprisingly firm, begin to soften. Existing home sales fell 7.6 percent in the Midwest, to the lowest rate in over a year. In the South sales fell by 3.0 percent, but were even with the sales rate of a year ago.

SINGLE-FAMILY HOME PRICES

	Median		Average	
	Existing	New	Existing	New
Mar 1989	$93,100	$126,000	$116,900	$152,200
Feb 1989	91,900	120,300	117,800	146,400
Jan 1989	89,700	115,000	113,000	139,300
Dec 1988	88,700	121,000	112,000	147,700
Nov 1988	88,500	110,400	112,400	137,300
Mar 1988	$88,900	$108,900	$111,600	$133,200
1988	89,300	112,500	112,800	138,200
1987	85,600	104,500	106,300	127,200
Mar 1989 Changes From:				
Feb 1989	1.3%	4.7%	-0.8%	3.9%
Mar 1988	4.7%	15.7%	4.7%	14.3%

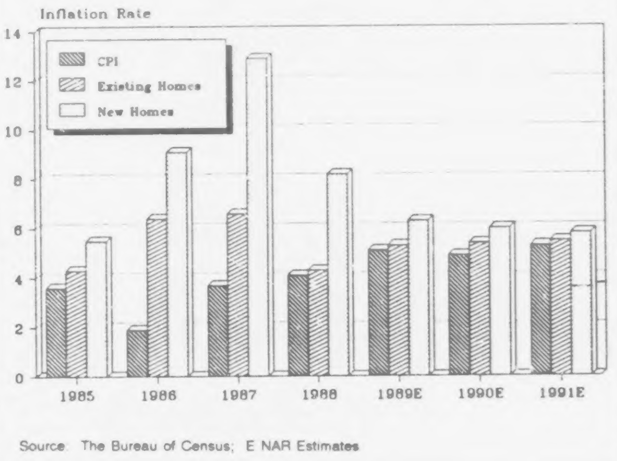
REGIONAL DATA

MEDIAN SALES PRICE OF AN EXISTING HOME

	Northeast	Midwest	South	West
Mar 1989	$146,100	$70,900	$85,700	$135,800
Feb 1989	142,600	69,900	86,700	127,800
Jan 1989	143,800	67,800	82,400	130,700
Dec 1988	143,000	67,700	78,200	128,700
Nov 1988	140,700	67,400	80,400	130,900
Mar 1988	$142,100	$67,200	$83,300	$119,900
1988	143,000	68,400	82,200	124,900
1989	133,300	66,000	80,400	113,200
Mar 1989 Change From:				
Feb 1989	2.4%	1.4%	-1.1%	6.3%
Mar 1988	2.8%	5.5%	2.9%	13.3%

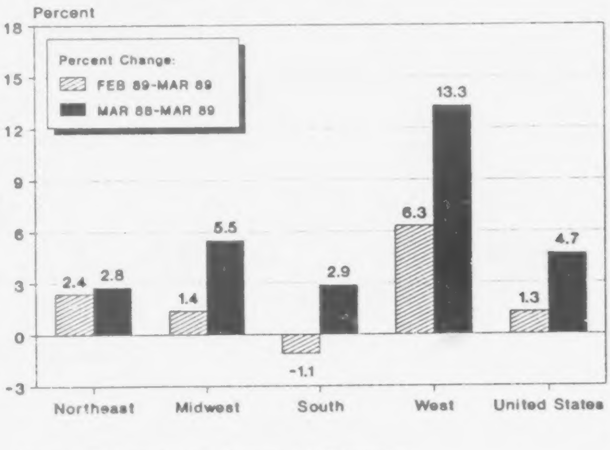
Source: NATIONAL ASSOCIATION OF REALTORS®, Economics and Research Division

GRAPH 13: HOME PRICES



Source: The Bureau of Census; E NAR Estimates

GRAPH 14: EXISTING HOME PRICES BY REGION



Source: NAR Economics and Research, E NAR Estimates

The latest 1.3 percent increase in the median price of an existing single-family home marked the fourth consecutive monthly rise, boosting the median sales price of an existing home to an all-time high of $93,100 in March. The median price of a new home leaped 4.7 percent in March to $126,000, marking a 15.7 percent increase over the $108,900 median sales price of a year ago. This rapid rise in new home prices is expected to moderate later this year, when lower interest rates attract homebuyers purchasing relatively lower priced new homes back into the market.

The rise in the price of an existing single-family home during March was led by the West, where the median price soared 6.3 percent to $135,800, a 13.3 percent increase over the median sales price of a year ago. The West was followed by the Northeast, whose median sales price rose 2.4 percent to $146,100, despite declining rates of sales. However, for the twelve months ending in March, the median sales price rose by only 2.8 percent, illustrating the housing slowdown in that region over the past year. In the Midwest, the median price of an existing home rose 1.4 percent in March to $70,900, 5.5 percent above the median price of a year ago. The only region to experience a decline in existing home prices was the South, where prices have been moving unpredictably for over a year. The latest move, a 1.1 percent decline, put the median sales price at $85,700.

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HOME EQUITY: HOW MUCH IS THERE, WHO HAS IT, WHERE IS IT?

Home equity -- house value net of mortgage debt -- amounted to about $3.2 trillion in the U.S. in 1985. Median home equity (over all homeowners) was about $43,000 in 1985, constituting the largest portion of the typical homeowner's wealth. This store of savings enhances a homeowner's ability to trade up to better housing or allows them to pull some equity out when they move. It also serves as a source of borrowing through second mortgages or home equity lines of credit. Moreover, the one-time exclusion of $125,000 capital gains on primary residences for those 55 years or older encourages homeowners to use home equity as a vehicle for long-term savings and then to establish the most suitable housing arrangement for their retirement years (i.e., trade down to smaller housing, or liquidate home equity and rent). The amount of home equity held is affected by house price inflation, but it clearly also depends on the amount of mortgage debt the homeowner decides to take. The level of mortgage debt taken is partly due to economic necessity, but also is influenced by the ability to deduct mortgage interest.

Homeownership and Home Equity

The newly released national American Housing Survey (AHS) for 1985 contains much more information on homeowners' mortgage instruments than in previous AHS surveys. In addition to more detail on the terms of mortgage loans, the 1985 survey, for the first time, collects this mortgage information for all homeowners instead of merely recent movers. This allows the calculation of outstanding mortgage debt as of 1985 and, consequently, home equity for all homeowners.[1]

Table 1 summarizes median amounts of home equity, as well as other indicators, nationally and by age, income and region. Of the 88.4 million households in 1985, there were 56.1 million homeowners, for a homeownership rate of 63.5 percent. The table reveals how sharply homeownership rises with both age and income. Less than 40 percent of households under 35 years old own their homes. The rate rises sharply thereafter, peaking at nearly 80 percent for those 55-64 years old, whereafter it falls as many elderly homeowners alter their living arrangements by becoming renters. The homeownership rate for households with below $10,000 income is 42 percent. The rate rises steadily until peaking at nearly 90 percent for incomes $50,000 and above.

Median home equity in 1985 for the nation was $43,285. Homeowners 55-64 years old had the highest median home equity. Clearly, younger homeowners have less home equity because they have more mortgage debt and have been homeowners fewer years; but median home equity of the 10 million homeowners less than 35 years old is nonetheless about $20,000. The drop in median home equity after 65 years of age, together with the drop in the homeownership rate after 65, document that many homeowners liquidate some or all of their home equity after retirement.

Not surprisingly, home equity holdings rise with income. Median home equity in 1985 was $35,000 for homeowners below $20,000 income, rising steadily with income until reaching $100,000 for homeowners with income $100,000 and above.

The last column of Table 1 shows that nationally, 42.7 percent of homeowners had no mortgage debt at all in 1985 (i.e., 57.3 percent had at least some). The percent with mortgage debt and the median amount of debt are, of course, much higher for younger homeowners. By retirement age, most homeowners own their homes free-and-clear: only 17 percent of homeowners 65 and over had any mortgage debt in 1985. The generally lower incomes of elderly homeowners with no mortgage debt help explain the low percentage of lower-income homeowners that hold mortgage debt.

The bottom panel of Table 1 summarizes regional disparities in homeownership and home equity holdings. The Northeast and the West have lower homeownership rates than the other regions, but their median holdings of home equity are about 60 percent higher. These two regions have experienced periods of quite rapid house price appreciation, leading to increases in home equity.

Distribution of Home Equity by Age, Income and Region

Data on median holdings of home equity are suggestive, but its distribution over particular dimensions provides a more complete picture. Tables 2, 3 and 4 present the national distribution of home equity over three dimensions: household age, income and region, respectively. Not surprisingly, older homeowners possess a substantial share of the nation's home equity. One half, or 6.9 million, of homeowners 65 or over held at least $50,000 in home equity in 1985; another 4.9 million held between $20,000 and $50,000. Home equity holdings are also substantial for middle-age homeowners. About half (54 percent) of the 20.1 million homeowners between 45 and 64 years old had at least $50,000 in home equity; another 6.3 million (31 percent) held between $20,000 and $50,000.

Table 1

Median Home Equity, 1985
By Household Age,Income, and Region
(Households in Thousands)

Household Class	Number of Households	Homeownership Rate	Number of Homeowners	Median Home Equity	Percent w/ Mortgage
All HHs	88,425	63.5%	56,145	$43,285	57.3%
Age:					
<35	25,521	39.1	9,983	20,488	84.9
35 - 44	18,013	68.0	12,243	40,000	84.2
45 - 54	12,818	75.2	9,637	50,000	67.3
55 - 64	13,177	79.3	10,447	54,537	43.3
65 - 74	11,284	77.6	8,757	50,000	21.8
75+	7,612	66.7	5,077	45,000	8.7
Income ($000):					
<10	20,073	42.3	8,499	34,999	26.0
10 - 20	20,243	53.5	10,821	35,000	41.6
20 - 30	17,139	65.2	11,182	40,000	58.9
30 - 40	11,913	75.6	9,011	42,300	70.0
40 - 50	7,183	84.1	6,041	50,000	73.9
50 - 100	10,057	89.1	8,960	65,000	78.8
100+	1,817	89.8	1,632	100,000	75.7
Region:					
Northeast	18,729	60.6	11,347	59,000	54.2
Midwest	22,142	66.3	14,673	37,000	55.8
South	30,064	66.1	19,858	36,136	54.8
West	17,490	58.7	10,267	60,000	67.6

Source: American Housing Survey, 1985.

Table 2

Home Equity By Household Age, 1985
(Thousands of Homeowners)

	Household Age							
Home Equity ($)	<35	35-44	45-54	55-64	65-74	75+	Total	Percent
0 or Negative	563	388	216	138	59	9	1,373	2.5
1 - 19,999	4,247	2,580	1,333	1,313	1,228	751	11,451	20.4
20,000 - 49,999	3,219	4,353	3,096	3,190	2,928	1,998	18,784	33.5
50,000 - 99,999	1,472	3,359	3,327	3,912	3,142	1,619	16,832	30.0
100,000 - 249,999	434	1,366	1,426	1,691	1,232	609	6,757	12.0
250,000+	48	197	239	203	169	91	948	1.7
Total	9,983	12,243	9,637	10,447	8,757	5,077	56,145	100.0

Table 3

Home Equity By Income, 1985
(Thousands of Homeowners)

Home Equity ($)	Income ($000)							
	≤10	10-20	20-30	30-40	40-50	50-100	100+	Total
0 or Negative	127	295	373	226	130	183	39	1,373
1 - 19,999	2,399	2,722	2,487	1,790	1,037	910	106	11,451
20,000 - 49,999	3,447	3,914	3,951	3,126	1,862	2,263	221	18,784
50,000 - 99,999	1,945	3,033	3,184	2,789	2,215	3,216	450	16,832
100,000 - 249,999	536	773	1,049	979	734	2,091	596	6,757
250,000+	46	83	138	101	63	297	221	948
Total	8,499	10,821	11,182	9,011	6,041	8,960	1,632	56,145

Table 4

Home Equity by Region, 1985
(Thousands of Homeowners)

Home Equity ($)	Region				
	Northeast	Midwest	South	West	Total
0 or Negative	219	325	586	243	1,373
1 - 19,999	1,431	3,358	5,046	1,615	11,451
20,000 - 49,999	3,129	5,971	7,227	2,457	18,784
50,000 - 99,999	3,964	4,214	5,211	3,444	16,832
100,000 - 249,999	2,293	740	1,560	2,165	6,757
250,000+	311	65	229	343	948
Total	11,347	14,673	19,858	10,267	56,145

Table 3 distributes home equity by income. In general higher-income homeowners hold more home equity. But there is also a substantial number of lower-income homeowners who possess significant home equity. For example, 30 percent of the 8.5 million homeowners with less than $10,000 income had $50,000 or more in home equity in 1985. This is largely due to the many "home-rich and cash poor" elderly homeowners.

Table 4 distributes home equity by region. Well over half of the homeowners with less than $20,000 home equity are less than 45 years old. The Northeast and the West regions contain the bulk of high-equity homes: two-thirds of the 7.7 million homes with at least $100,000 home equity were in these two regions in 1985, even though less than 40 percent of all homes were located there.

by
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Director of Housing Research

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1. The AHS contains detailed information on the first and second mortgages associated with the surveyed residence, including current mortgage interest rates, when the mortgages were acquired, their terms, and the mortgage amounts when acquired. This allows for calculating the outstanding balance in 1985 on each of the mortgages by essentially paying down each mortgage between acquisition and 1985. Total mortgage debt is the sum of these two balances, and home equity is current market value on the home net of total mortgage debt.

REDUCED TAX BENEFITS FOR HOMEOWNERSHIP MEAN REDUCED HOMEBUYING

Federal income tax rates were reduced substantially by the Tax Reform Act (TRA) of 1986. Lower tax rates, in turn, meant that each dollar of mortgage interest expense deducted on their income tax returns saved homeowners less taxes than they did before TRA. NAR's National Homeownership Survey conducted in 1986 was designed in part to find out how such reduced tax benefits would affect homebuying plans.

NAR'S NATIONAL HOMEOWNERSHIP SURVEY

A nationally representative sample of households--including both renters and owners--was asked whether or not they planned to buy a home within the next ten years. Those who answered "yes" were then asked whether or not their plans would be altered by the reduced tax benefits from deducting mortgage interest expense because of TRA's rate reductions.[1] The following table shows the percentages of prospective homebuyers who said their purchase plans would be altered as well as a breakdown by types of responses.

EFFECTS ON HOMEBUYING DECISION FROM REDUCED MORTGAGE INTEREST DEDUCTIBILITY TAX BENEFITS

Response to Tax Rate Reductions	ALL Prospective Homebuyers*	Current Renters	Current Owners
Planned Purchase Would Be Altered	**36.7%**	**43.8%**	**32.5%**
Delay Purchase Temporarily	20.7	33.6	13.0
Delay Purchase Indefinitely	7.3	2.1	10.5
Buy Less Expensive House	13.0	12.7	13.2
Rent Instead of Buy	2.8	5.0	1.4
Planned Purchase Would Not Be Altered	**63.3**	**56.2**	**67.5**

* Respondents were permitted to indicate multiple ways that their purchase plans would be altered; therefore, the percent of prospective homebuyers saying they would alter their purchase plans is less than the total for the four individual categories of responses.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®, National Homeownership Survey, Unpublished Data (1986).

TYPES OF RESPONSES TO REDUCED TAX BENEFITS

As shown in the above table, over one-third of all prospective homebuyers said they would alter their planned purchase of a house as a result of reduced tax benefits from itemizing mortgage interest expenses. However, current renters were more likely to alter their planned purchases than were current owners (43.8% vs. 32.5%).

Overall, one out of every five (20.7%) prospective homebuyers would temporarily postpone buying, 13 percent would buy a less expensive unit, 7.3 percent would stay in their current dwelling, and 2.8 percent would rent their next unit rather than buy as planned.

Current renters and current owners differed markedly in how they said they would alter their planned home purchases. More than three out of four renters who said they would alter their planned home purchases would delay them until they "get more money for a downpayment." Not surprisingly, only two out of five affected owners would delay their purchases for this reason.

Prospective homebuyers who currently rented were more than twice as likely to delay their home purchases temporarily as to buy less expensive homes (33.6% vs. 12.7%). Current owners, however, were as likely to buy less expensive homes as to delay their purchases temporarily (13.2% vs. 13.0%). Moreover, current owners were five times as likely as current renters to delay indefinitely their planned purchase of another house (10.5% vs. 2.1%).

DIFFERENCES AMONG PROSPECTIVE HOMEBUYERS RESPONDING DIFFERENTLY TO REDUCED TAX BENEFITS FROM HOMEOWNERSHIP

Response to Tax Rate Reductions	Current Renters Income	Current Renters Saving Rate	Current Renters Age	Current Owners Income	Current Owners Saving Rate	Current Owners Age
Planned Purchase Would be Altered	**$22,030**	**3.4%**	**34.5**	**$26,801**	**5.4%**	**44.2**
Delay Purchase Temporarily	22,766	3.4	34.5	25,945	6.1	37.4
Delay Purchase Indefinitely	25,156	6.1	42.5	23,977	4.6	46.7
Buy Less Expensive House	19,531	2.9	36.9	29,247	5.5	48.9
Rent Instead of Buy	16,842	2.6	32.4	39,306	5.5	45.0
Planned Purchase Not Altered	**22,541**	**4.6**	**36.7**	**32,583**	**6.3**	**41.4**

SOURCE: NATIONAL ASSOCIATION OF REALTORS® National Homeownership Survey, Unpublished Data (1986)

WHY PROSPECTIVE HOMEBUYER RESPONSES DIFFER

Renters who said they would alter their home purchase plans because of reduced tax savings from the mortgage interest deduction are most distinguishable by their low incomes and low savings rates. Indeed, the lower the incomes and savings rates the more drastic the adjustment. Renters who would temporarily delay their purchases had an average income of $22,766 and savings rate of 3.4 percent as compared with an income of $22,541 and a savings rate of 4.6 percent for renters with unaltered purchase plans. Renters who would buy a less expensive house than planned had an average income of $19,531 and a savings rate of 2.9 percent; renters who would rent their next unit instead of buying as planned had an average income of $16,842 and a savings rate of 2.6 percent.

Current owners who said they would alter their planned house purchases because of reduced tax savings from mortgage interest deductibility would appear to do so for quite different reasons than would current renters. Whereas current renters opting to rent rather than buy their next homes because of reduced tax benefits tend to be young, single households with low incomes and low saving rates, current owners who said they would rent rather than buy tend to be older, married households with high incomes and high saving rates.

SUMMING UP

Writing in 1986 shortly after TRA was enacted, a leading housing economist attempted to foresee what effects reduced income tax rates would have on homeownership:

> Clearly, tax advantages are not the only reason for 4buying a home, and most households will proceed to act as if nothing had changed. But the loss of these tax benefits could deter some from doing so, or at least delay them.[2]

Based upon results from NAR's National Homeownership Survey, the writer was prescient because most prospective homebuyers did in fact say they would be unaffected by the loss of tax savings from the mortgage interest deduction. However, the proportion saying their planned home purchase would be adversely affected was sizeable. Indeed, over one-third would delay their purchase, buy a less expensive home, or rent instead of buying.

Moreover, households would be affected quite differently depending on their particular stage in the life cycle and whether first-time or repeat homebuyers. Prospective first-time homebuyers were more likely to delay their planned purchases, for example, while prospective repeat homebuyers were more likely to be deterred from trading-up--instead, remaining in their current homes, buying smaller homes, or even becoming renters.

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[1] Surveyed households were told that TRA would reduce tax savings, on average, from about $35 to about $15 for every $100 of mortgage interest expense deducted.

[2] Daniel N. Chambers, "The Homeowner Market," Chapter 1 in Homebuilding After Tax Reform (Washington, D.C.: National Association of Homebuilders, 1986), p. 6.

U.S. ECONOMIC OUTLOOK

MAY 1989

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	88.4	89.1	89.2	89.3	89.4	90.1	90.2	90.3	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5000	5117	5206	5281	5354	5440	5514	5589	4527	4864	5239	5552	5901
% Change	7.6	9.7	7.2	5.8	5.6	6.6	5.6	5.6	6.8	7.5	7.7	6.0	6.3
% Change (w/out inflation)	2.4	5.5	2.2	2.2	1.8	2.0	1.5	1.7	3.4	3.9	3.1	1.8	1.9
Consumer Price Inflation (CPI)	4.4	5.4	5.9	4.6	4.6	5.0	4.8	4.8	3.7	4.1	5.1	4.9	5.3
GNP Inflation (GNP Deflator)	5.3	3.9	4.7	3.6	3.7	4.5	4.0	3.8	3.3	3.4	4.5	4.0	4.3
Unemployment Rate - Civilian	5.3	5.2	5.2	5.1	5.1	5.1	5.3	5.4	6.2	5.5	5.2	5.3	5.6
Civilian Employment-Household Basis (millions)	115.8	116.9	117.4	117.9	118.4	118.7	119.0	119.3	112.4	115.0	117.6	119.1	120.1
Percent change	2.2	3.7	1.7	1.8	1.5	1.2	0.9	1.0	2.6	2.3	2.3	1.3	0.8
Index of Industrial Production	139.9	141.0	142.0	142.7	143.4	144.0	144.4	144.9	129.8	137.2	142.3	144.7	146.7
Manufacturing Capacity Utilization	84.4	84.7	84.9	85.1	84.9	84.9	84.7	84.4	81.0	83.6	84.9	84.5	83.1
Domestic Auto Sales	7.5	6.9	7.2	7.1	7.2	7.2	7.2	7.1	7.1	7.5	7.1	7.2	7.0
Federal Tax Receipts (NIPA) as % of GNP	19.8	20.0	20.4	20.4	20.4	20.9	20.8	20.8	20.2	20.1	20.3	20.8	20.8
Federal Expenditures (NIPA) as % of GNP	23.0	23.0	22.8	22.7	22.7	22.8	22.8	22.8	23.7	23.0	22.8	22.8	22.7
Deficit(NIPA)	-157.5	-151.7	-125.3	-123.3	-121.4	-106.6	-107.6	-109.1	-157.8	-142.4	-130.4	-108.8	-110.6
as % of GNP	-3.2	-3.0	-2.4	-2.3	-2.3	-2.0	-2.0	-2.0	-3.5	-2.9	-2.5	-2.0	-1.9
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4874	4496	4503	4620	4519	4371	4397	4448	4648	4651	4535	4389	4443
Percent change – year ago	9.6	-2.0	-3.6	-1.5	-7.3	-2.8	-2.4	-3.7	-1.4	0.1	-2.5	-3.2	1.2
Existing Single-family Home Sales (thousands)	3770	3453	3480	3570	3490	3335	3380	3410	3526	3594	3498	3360	3405
Percent change – year ago	11.2	4.6	-4.5	-2.5	-7.4	-3.4	-2.9	-4.5	-1.1	1.9	-2.7	-4.0	1.3
Housing Starts (thousands)	1559	1517	1470	1511	1473	1485	1457	1488	1634	1496	1493	1475	1492
Percent change – year ago	1.7	2.7	-0.7	3.1	-5.5	-2.1	-0.9	-1.5	-9.8	-8.5	-0.2	-1.2	1.1
Single-Family Units	1138	1076	1055	1083	1060	1068	1049	1070	1157	1089	1068	1061	1070
Percent change – year ago	4.5	-1.9	-0.7	2.1	-6.8	-0.8	-0.6	-1.2	-2.2	-5.8	-1.9	-0.7	0.9
Multi-Family Units	420	441	416	429	413	417	409	418	477	406	425	415	422
2-4 Family Units	65	57	53	55	53	54	53	54	66	59	55	53	54
Percent change – year ago	16.0	0.6	-6.9	-3.5	-18.8	-5.5	-1.7	-2.4	-22.6	-10.3	-7.6	-2.3	1.8
5 + Family Units	355	385	362	374	360	363	356	365	412	347	370	362	368
Percent change – year ago	-8.2	18.8	0.3	7.0	1.4	-5.5	-1.7	-2.4	-24.4	-15.7	6.6	-2.3	1.8
New Single-family Home Sales (thousands)	682	634	653	670	605	570	585	607	671	677	641	587	624
Percent change – year ago	9.8	0.6	-6.3	-4.7	-11.3	-10.1	-10.4	-9.4	-10.5	0.9	-5.4	-8.4	6.3
Mobile Homes Shipped (thousands)	223	223	234	246	244	244	241	245	233	217	237	243	243
HOME PRICES													
Existing Home Prices - Median $(1000)	88.7	91.6	93.8	95.1	95.6	96.7	98.4	99.5	85.6	89.3	94.0	99.1	104.6
Percent change – year ago	4.4	4.3	5.5	5.4	7.8	5.6	4.9	4.6	6.6	4.3	5.3	5.4	5.5
New Home Prices - Median $(1000)	114.9	120.4	118.5	119.7	119.7	122.0	124.3	127.1	104.0	112.5	119.6	126.7	134.1
Percent change – year ago	2.8	6.6	4.9	4.2	4.2	1.3	4.9	6.2	13.0	8.2	6.3	6.0	5.8
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.6	10.9	11.2	11.1	10.8	10.7	10.6	10.5	10.2	10.5	11.0	10.6	10.3
1-year ARM (without buydown)	8.5	8.8	9.1	8.9	8.7	8.6	8.5	8.4	8.5	8.5	8.9	8.5	8.1
Corporate AAA Bond Rate	9.5	9.7	10.2	10.0	9.9	9.7	9.7	9.6	9.4	9.7	10.0	9.9	9.6
Government Bond Rate	9.0	9.0	9.4	9.3	9.1	9.0	9.0	9.0	8.6	9.0	9.2	9.0	8.8
Short-Term Interest Rates													
Federal Funds Rate	8.5	9.4	10.0	9.8	9.5	9.0	8.6	8.5	6.7	7.6	9.7	8.8	7.5
3-month T-Bill Rate	7.7	8.5	9.3	9.1	8.7	8.4	8.1	8.0	5.8	6.7	8.9	8.1	6.5
Prime Rate	10.2	11.0	11.8	11.6	11.2	10.8	10.4	10.2	8.2	9.3	11.4	10.4	9.5
Discount Rate	6.5	6.7	7.0	7.1	6.9	6.7	6.5	6.5	5.7	6.2	7.0	6.8	6.3
Value of the U.S. Dollar (Trade-Weighted Avg.)	93.0	96.0	96.6	94.2	92.7	91.1	89.4	87.5	96.9	92.8	94.9	88.4	81.6
Percent change	-17.6	13.5	2.8	-9.5	-6.4	-6.8	-7.4	-8.2	-13.6	-4.3	2.3	-6.8	-7.6

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz.

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Vol. 2, No. 6

OUTLOOK

June 1989

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The U.S. Department of Commerce cut its estimate of first quarter real GNP growth dramatically to 4.3 percent from 5.5 percent, indicating a much slower rate of economic activity in the opening months of 1989.
- The dollar reached a 29 month high in May, encouraged primarily by high U.S. interest rates relative to those in Germany, Japan and the U.K. In addition, political problems in Europe and Japan, higher oil prices, and the attraction of the U.S. stock and bond markets to foreign investors, all added to the new found interest in the dollar.
- In response to the recent rally in the bond market, which forced long-term rates down by over 50 basis points, fixed-rate mortgages have fallen to their lowest levels so far in 1989. The average rate on a conventional fixed-rate mortgage has plunged by almost 100 basis points in the past two months, to 10.5 percent in the final week of May.
- Prompted by a large drop in the construction of buildings with five or more housing units, housing starts slowed by 2.7 percent in April to an annual rate of 1.361 million units. However, starts of single-family units rebounded 5.1 percent to an annual rate of 1.036 million units, after falling 4.2 percent in March and 14.2 percent in February.
- Following two consecutive months of substantial declines, sales of new single-family homes staged a comeback in April, leaping 10.9 percent to a seasonally adjusted annual rate of 620 thousand units. New home sales are expected to climb modestly during the second quarter, a trend which could be strengthened if interest rates continue to decline during June.
- Existing single-family home sales declined for the fourth consecutive month in April, sliding to an annual rate of 3.36 million units, or 1.2 percent slower than the March annual rate of 3.4 million units. However, with the recent retreat in interest rates, existing home sales are most likely at, or near, their low point for 1989.
- The median price of an existing single-family home rose 1.6 percent in April to $93,500, marking the fifth consecutive monthly advance. Meanwhile, the sales price of a new single-family home plunged 7.1 percent to $117,000.

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SOMETHIN'S HAPPENIN' HERE

Economic Commentary

by

John A. Tuccillo
Chief Economist and
Senior Vice President
Real Estate Finance

Mobs of students battle authority in the central park of a major city while important political meetings take place nearby; politicized rock bands blare their messages from underground locations to the consternation of the establishment. The U.S. in 1968. No. China and the U.S.S.R. in 1989? Yes. Sure is a different world out there. In the words of Steven Stills, "Somethin's happenin' here, and what it is ain't exactly clear...." Well, let's take a crack at an explanation.

Several years ago (before it became as usual as a bus trip across town), a friend visited Australia. When I asked him what it was like, he described it as the U.S. in the Fifties. And while history doesn't repeat itself in quite the same way every time, we may now be able to describe the Eastern Bloc as the U.S. in the Sixties. In both China and the Soviet Union, we are witnessing a ferment generated from a generation for whom the capitalist door has been held slightly ajar. And because both societies have become more capitalist, the level of tension between us and them has dropped noticeably (as the late Emily Litella would ask, "What's all this about glass noses?"). The world, in short, is converging at a bewildering rate, and because the Russians and the Chinese have seen a little market economics personally and because the media has shown them the rest, their youth has become as restless as the angry Boomers were in the Sixties right here.

We see the homogenization of the world economy in a variety of ways, but not always with the same eyes. The consumer who is tickled to see the pressure of Japanese, German, British and Korean imports touch off fire sales at dealers of American cars looks at life a bit differently from the auto worker whose job on the line is on the line. And beyond these tangible signs of our interdependency with other nations, there is a pervasive consciousness of, and growing sensitivity to, events and conditions throughout the global village. To a great degree, electronics have shrunk space. We transmit money and images instantaneously and o interest in Japanese politics and British stock prices goes up considerably.

But let's bring this a little closer to home. The real estate community has been increasingly concerned about the spread of foreign ownership of American property. In part, this is a function of our considerable foreign trade deficit -- after all, you can only spend dollars in the U.S. But it's also a function of the remarkably lower prices commercial real estate fetches in the U.S. compared to similar buildings abroad. This has been true for quite some time, and some foreign investors have been here for a while. But the shrinking of the world and the tremendous interest in the workings of the American economy have let out the closely held secret, with the resulting boom in foreign ownership.

Secondly, the barrage of information that has resulted from fiber optics and miniaturization has jaded the American public, but has made that public a more knowledgeable consumer. The "secrets of the temple" that had made the financial sector so impenetrable have been exposed by an avalanche of financial news reporting. The result is that the home buyer knows more about interest rates and mortgage types than any of us would have thought possible as recently as ten years ago. Moreover, the video age has produced consumers who receive messages electronically, challenging real estate professionals to think long and hard about marketing techniques that can capitalize on the new sophistication. Clearly, this is a new, but continuing twist on the constant challenge of selling real estate.

Finally, the electronic convergence of the world has blurred the lines that previously separated aspects of the real estate transaction and will continue to do so. The current debate over computerized mortgage origination and the role of the real estate broker has its genesis in the capacity to telescope the mortgage lending process. In reality, the real estate office is just a way station in the evolution and may in fact be superceded by the direct contact via computer between the provider of funds and the user of funds. But, at the moment, the whole mortgage financing landscape is shifting and those involved are understandably confused at the change.

It's a human characteristic that we fail to notice the occurrence of events that later go on to have tremendous impact on everyday life. Recently, this came to mind with the passage of the 50th anniversary of the invention of the pay phone. In a sen, the things that will be the crucial influences on our lives are coming into being now. But unlike the past, when few knew when things happened, so much is occurring that mere knowledge is not the problem; rather, understanding and the time necessary to understand are what fail us.

Outlook for the Economy and Real Estate

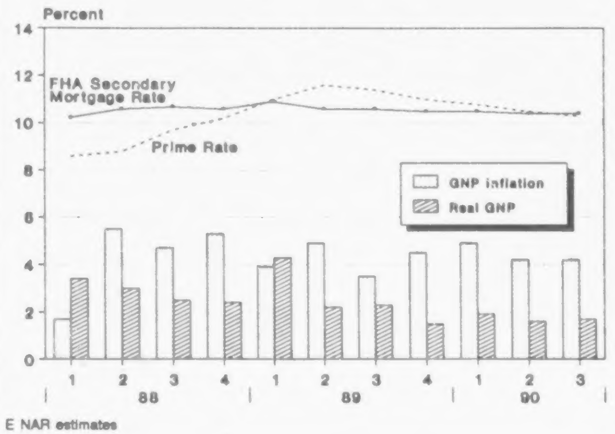
ECONOMIC OUTLOOK

The U.S. Department of Commerce cut its estimate of first quarter real GNP growth dramatically to 4.3 percent from 5.5 percent, indicating a much slower rate of economic activity in the opening months of 1989. The Commerce Department did not, however, modify its drought adjustments which added 2.5 percentage points to the first quarter growth estimate. The revision, then, was principally to real non-farm growth which slowed to an annual rate of 1.8 percent, well below the 3.5 percent non-farm growth rate in the fourth quarter of 1988. While the recent revision did allay fears that the economy may be overheating and thus heading for a difficult struggle with inflation, it also added fuel to growing concerns that the Federal Reserve may have tightened the money supply a bit too much, risking a future brush with a recession. However, the composition of the downward revision suggests otherwise. The revision was encouraged primarily by a 64 percent reduction in the estimate for inventory accumulation, from $24.7 billion to $8.9 billion. Large stock piles near the end of an expansion generally lead to recessionary fears, in that they tend to spur production cutbacks and employment layoffs. Such a large downward revision in the inventory number suggests this is not at hand. The net exports estimate was revised upward by 80 percent to $17.6 billion, while the consumption and fixed investment estimates were lowered slightly.

Just as increased inventory investment can enhance the risk of a recession, business fixed investment in structures and equipment can do the opposite. Fixed investment increases capacity and productivity, thereby reducing the chances of backlogs and shortages. Further, it boosts U.S. competitiveness vis-a-vis the rest of the world. A closely watched barometer of future business fixed investment is the rate of new orders for non-defense capital goods. This indicator has been sluggish during the first quarter of 1989, reflecting the rather strong fixed investment in equipment (up 8.3 percent in the first quarter after falling 3.3 percent in the fourth quarter of 1989) already underway at the nations factories. However, in April orders shot up by 6.1 percent in what amounted to the largest monthly advance since December of 1988. Further indications of the surprisingly good health at the nations factories came from a 2.7 percent jump in new orders for manufactured goods, following three months of declining or anemic growth.

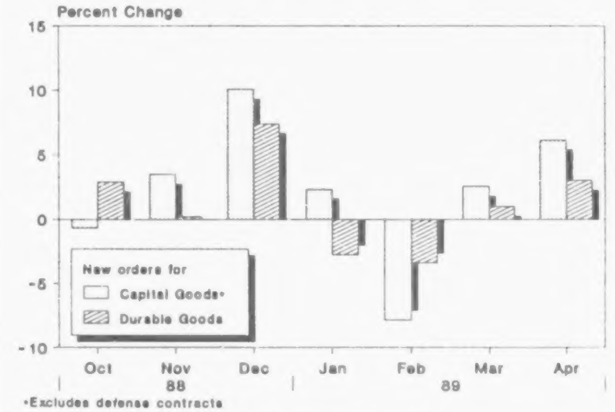
The 0.8 percent rise in the index of leading economic indicators in April offered additional proof of the economy's continued buoyancy. The index is designed to foreshadow economic growth by combining 11 separate economic indicators (unemployment claims, length of the average work week, consumer and capital goods orders, inventories, selected raw materials and stock prices, money supply, building permits, and delivery speed) generally thought to be good gauges of future economic activity. The April gain was widespread, with only consumer confidence, money supply, and materials prices pulling the index down, while all other eight components showed considerable signs of strength. The April rise broke a two month series of declines -- an important signal in itself -- as three consecutive monthly declines are sometimes thought to foreshadow an upcoming recession. Nevertheless, April's report helped calm the recessionary fears heightened by a flurry of negative economic reports for February and March.

GRAPH 1: THE ECONOMIC OUTLOOK



E NAR estimates

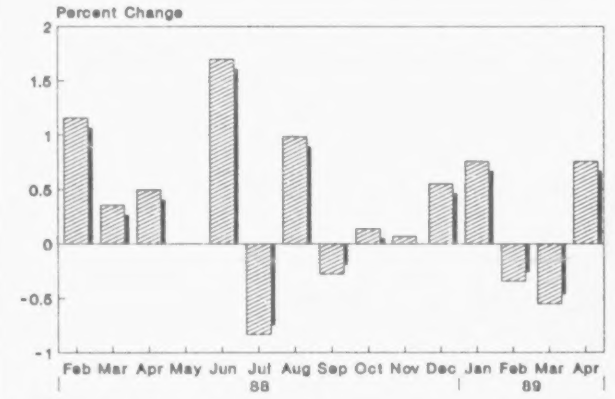
GRAPH 2: NEW ORDERS FOR MANUFACTURED GOODS MAKE A COMEBACK IN APRIL



•Excludes defense contracts

Source: Advance Report on Durable Goods Shipments and Orders

GRAPH 3: THE INDEX OF LEADING INDICATORS SHOWS NEW ECONOMIC STRENGTH



Source: The Bureau of Economic Analysis

The New Strength of the Dollar

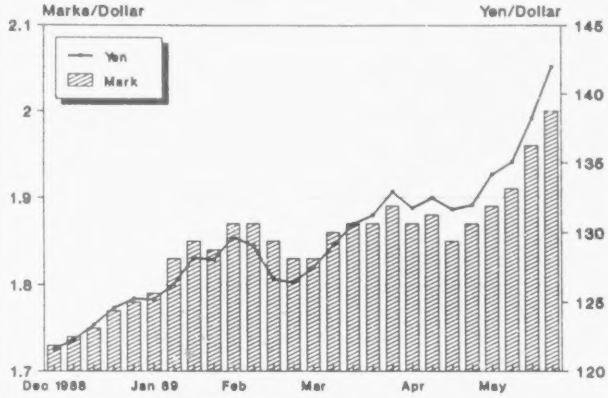
The dollar reached a 29 month high in May, encouraged primarily by high U.S. interest rates relative to those in Germany, Japan and the U.K. In addition, political problems in Europe and Japan, higher oil prices, and the attraction of the U.S. stock and bond markets to foreign investors, all added to the new found interest in the dollar. The result has been to take the dollar well out of the 1.7-1.9 mark and 120-140 yen trading ranges believed to be set by the G-7 ministers (economic ministers of the U.S., Great Britain, West Germany, France, the Netherlands, Canada, and Japan), and above what have become psychologically important barriers of 2.0 marks and 140 yen. The higher dollar will most likely complicate efforts by U.S. manufacturers to increase exports, as a rise in the dollar of this magnitude more than erases months of productivity gains. This would in turn slow the export driven growth that many policy makers are hoping will allow for the economic "soft landing" during the next year. In addition, a higher dollar may reverse the trend of improvement in the trade deficit which fell in March to $8.9 billion from $9.8 in February. In the opening days of June the dollar began to show some signs of retreat, following a round of concerted central bank intervention and the first increase in the Japanese discount rate in nine years, from 2.5 to 3.25 percent. However, an easing of U.S. interest rates in the coming weeks will likely be necessary to reduce the attraction of dollar-denominated investments in relation to comparable foreign securities.

MONETARY POLICY AND INTEREST RATES

The rising U.S. dollar, combined with signs of slower economic growth and moderate inflation (the CPI rose by a modest 0.2 percent excluding energy in April), has led the Federal Reserve to consider a policy of looser credit in recent weeks. Although the Fed did not join the Japanese central bank in a concerted interest rate change (a step which would have strengthened considerably the G-7's control over exchange rates) there is some indication that the Fed will ease its credit policy in the coming weeks. Most analysts are expecting a 0.25 percentage point drop in the federal funds rate, which has fluctuated in a narrow range of 9.75 to 9.85 for over two months. Interest rates have drifted lower over the past two months, primarily on the news of subdued economic growth and expectations of slower rates of inflation. Graph 5 shows how the initial drop in interest rates during April came at the short end of the yield curve, while more recent declines have been concentrated on long term rates. The result has been a near flattening of the yield curve with rates on all terms ending May more than 50 basis points below those prevailing in March.

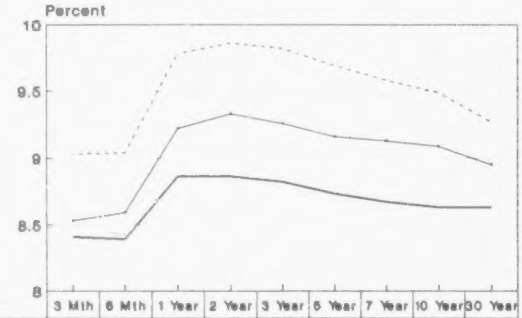
In response to the recent bond rally, fixed-rate mortgages have fallen to their lowest levels so far in 1989. The average rate on a conventional fixed-rate mortgage has plunged by almost 100 basis points in the past two months, to 10.5 percent in the final week of May. More aggressive lenders have been offering rates as low as 10.25 percent on a 30-year fixed rate mortgage. If the Federal Reserve loosens credit in the coming weeks as expected, mortgage rates will most likely fall even further, particularly those on ARMs whose recent decline has been less dramatic. Lower rates could draw homebuyers off the fence and into the market this summer, bolstering sales which have been weak so far this year.

GRAPH 4: THE DOLLAR RISES AGAINST THE MARK AND THE YEN



Source: Generale de Banque, New York.

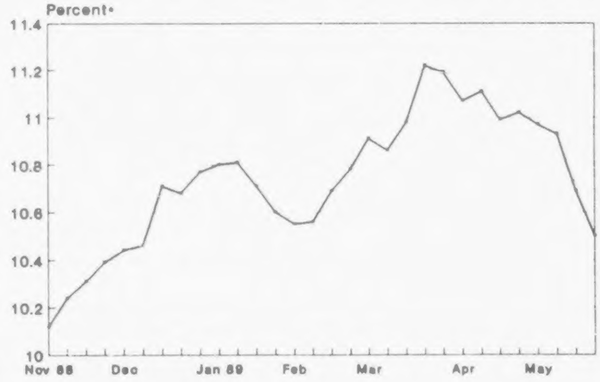
GRAPH 5: THE YIELD CURVE



	3 Mth	6 Mth	1 Year	2 Year	3 Year	5 Year	7 Year	10 Year	30 Year
Mar 25 ----	9.03	9.04	9.78	9.86	9.82	9.69	9.58	9.49	9.27
Apr 25 —·—	8.53	8.59	9.22	9.33	9.26	9.16	9.13	9.09	8.95
May 26 ——	8.41	8.39	8.86	8.86	8.82	8.73	8.67	8.63	8.63

Source: The Federal Reserve Board.

GRAPH 6: FIXED-RATE MORTGAGES FALL TO THEIR LOWEST LEVEL OF THE YEAR



*Contract interest rates on commitments for fixed-rate first mortgages.

Source: Board of Governors of the Federal Reserve System.

HOUSING STARTS

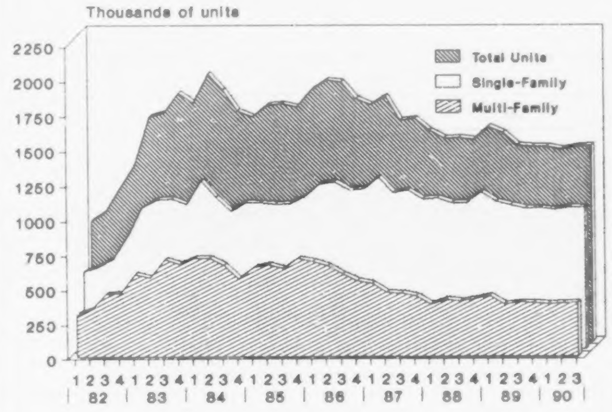
(Seasonally Adjusted Annual Rates, in Thousands)

		Total	S-F	2-4	5 and up
Apr	1989	1361	1036	68	257
Mar	1989	1399	986	51	362
Feb	1989	1465	1029	62	374
Jan	1989	1678	1199	66	413
Dec	1988	1577	1141	65	371
Apr	1988	11576	1087	58	431
April 1989 Change From:					
Mar	1989	-2.7%	5.1%	33.3%	-29.0%
Apr	1988	-13.6%	-4.7%	17.2%	-40.4%

		Northeast	Midwest	South	West
Apr	1989	208	227	529	347
Mar	1989	153	306	551	389
Feb	1989	224	273	572	396
Jan	1989	293	313	642	430
Dec	1988	210	343	609	424
Apr	1988	260	344	595	377
April 1989 Change From:					
Mar	1989	36.0%	-9.5%	-4.0%	-10.8%
Apr	1988	-20.0%	-19.5%	-11.1%	-8.0%

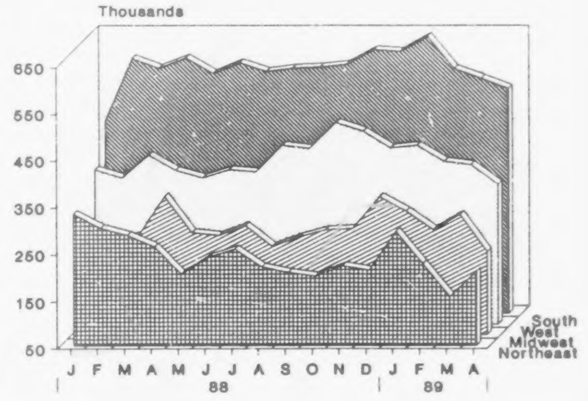
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: The Bureau of Census; E NAR Estimates

GRAPH 8: HOUSING STARTS BY REGION



Source: The Bureau of Census

Prompted by a large drop in the construction of buildings with five or more housing units, housing starts slowed by 2.7 percent in April to an annual rate of 1.361 million units. However, starts of single-family units rebounded 5.1 percent to an annual rate of 1.036 million units, after falling 4.2 percent in March and 14.2 percent in February. In April, starts of multi-family units with five or more units fell 29 percent to an annual rate of 257 thousand units. Because of the large monthy swings in the starts of multi-family units, they tend to be a poor barometer of housing activity. The increase in single-family starts alleviated some fears that the housing industry may be heading for a recession. Furthermore, the decline in interest rates during May creates the possibility of even stronger rates of housing construction in the coming months. However, slower economic growth will continue to contain future housing construction, as housing starts will likely average between 1.4 and 1.43 million units through the rest of 1989.

Housing starts showed continued signs of weakness in every region except the Northeast, where starts were up 36.0 percent to an annual rate of 208 thousand units. However, this drop only partly compensated for the combined 47.8 percent drop during February and March. In the West, starts plunged 10.8 percent to a rate of 347 thousand units, slower than any rate since December 1987. Starts were down 9.5 percent in the Midwest and 4.0 percent in the South, at annual rates of 277 and 529 thousand units, respectively.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Apr 1989	620	Sep 1988	691
Mar 1989	559	Aug 1988	555
Feb 1989	624	Jul 1988	691
Jan 1989	700	Jun 1988	712
Dec 1988	669	May 1988	701
Nov 1988	650	Apr 1988	716
Oct 1988	718		

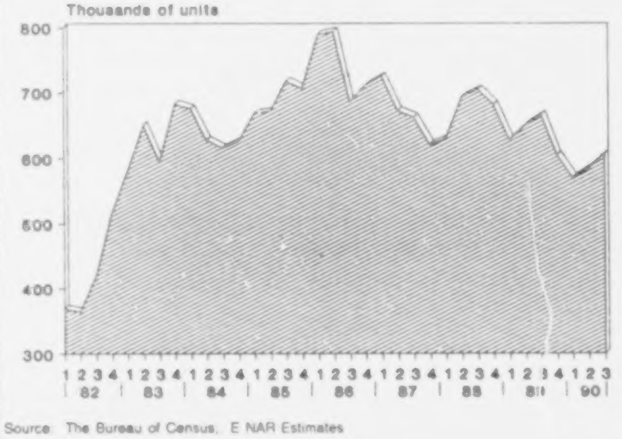
Apr 1989 Changes From:		Annual Totals:	
Mar 1989	10.9%	1987	671
Apr 1988	-8.4%	1988	677

REGIONAL DATA

	Northeast	Midwest	South	West
Apr 1989	96	96	234	193
Mar 1989	116	103	193	147
Feb 1989	87	107	232	199
Jan 1989	121	106	265	207
Dec 1989	109	94	263	204
Nov 1988	65	104	254	227
Apr 1988	109	93	287	188
1988	102	97	275	202
1987	134	102	288	140
Apr 89 Changes From:				
Mar 1989	-17.2%	-6.8%	21.2%	31.3%
Apr 1988	-11.9%	3.2%	-18.5%	2.7%

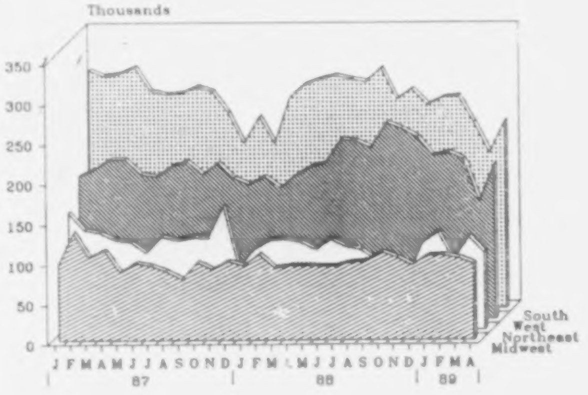
Source: Bureau of the Census, Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: The Bureau of Census, E NAR Estimates

GRAPH 10: NEW HOME SALES BY REGION



Source: The Bureau of Census

Following two consecutive months of substantial declines, sales of new single-family homes staged a comeback in April, leaping 10.9 percent to a seasonally adjusted annual rate of 620 thousand units. However, what amounted to the largest monthly increase since February 1988, only partly made up for the 20.1 percent decline from January to March: sales remained well below the 677 thousand unit rate of April 1988. New home sales are expected to climb modestly during the second quarter, a trend which could be strengthened if interest rates continue to decline during June. Sales will most likely remain stable in the third quarter before dropping off in the fourth with slower economic growth.

The April rebound was fueled entirely by a return to more "normal" rates of sales in the West and South, following depressed sales during February and March in both regions. In the West, sales climbed 31.3 percent to an annual rate of 193 thousand units. The impressive gain was not, however, strong enough to make up for the 3.9 and 26.1 percent declines during February and March, respectively. Sales were up 21.2 percent in the South at an annual rate of 234 thousand units. Here too, because of large declines during February and March, sales remained below the January rate of 265 thousand units. Sales continued their erratic, see-saw behavior in the Northeast, dropping 17.2 percent in April, following a 33.3 percent increase in March. In the Midwest, sales have maintained their relatively stable and steady course when compared to the other three regions, falling 6.8 percent to a seasonally adjusted annual rate of 96 thousand units.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Apr 1989	3360	Sep 1988	3640
Mar 1989	3400	Aug 1988	3690
Feb 1989	3480	Jul 1988	3650
Jan 1989	3550	Jun 1988	3800
Dec 1988	3920	May 1988	3620
Nov 1988	3710	Apr 1988	3510
Oct 1988	3680		

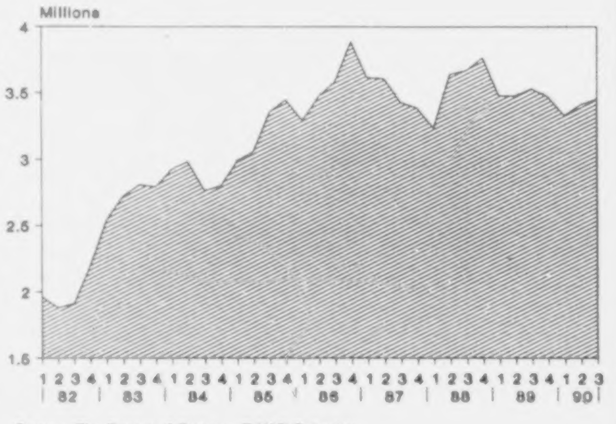
Apr 1989 Changes From:		Annual Totals:	
Mar 1989	-1.2%	1988	3594
Apr 1988	-4.3%	1987	3526

REGIONAL DATA

	Northeast	Midwest	South	West
Apr 1989	610	890	1270	620
Mar 1989	570	870	1270	670
Feb 1989	600	920	1310	640
Jan 1989	710	930	1310	630
Dec 1988	700	1010	1500	700
Nov 1988	680	940	1410	680
Oct 1988	640	940	1410	690
Apr 1988	600	910	1320	620
1988	673	929	1350	642
1987	685	959	1282	600
Apr 1989 Changes From:				
Mar 1989	7.0%	2.3%	0.0%	-7.5%
Apr 1988	-7.6%	-2.2%	-3.8%	0.0%

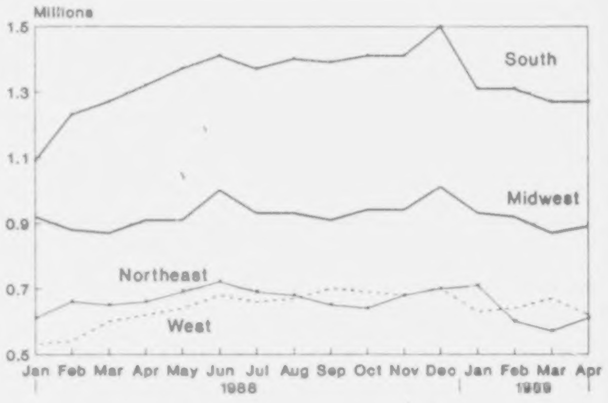
Source: NATIONAL ASSOCIATION OF REALTORS®, Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: The Bureau of Census; E NAR Estimates

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics and Research; E NAR Estimates

Existing single-family home sales declined for a fourth consecutive month in April, sliding to an annual rate of 3.36 million units, or 1.2 percent slower than the March annual rate of 3.4 million units. The April existing home sales rate was down 4.3 percetn from the April 1988 annual rate of 3.51 million units. Overall, the pace of existing home sales through the first four months of 1989 is virtually identical to 1988 sales volume over the same period. The big difference is in the trend: home sales started slowly in January 1988 and increased through April and beyond; whereas, in 1989, home sales showed considerable strength in January, but have slowed steadily ever since. However, with the recent retreat in interest rates, existing home sales are most likely at, or near, their low point for 1989.

Regionally, existing home sales moved in precisely the opposite direction as sales of new homes, with sales of existing homes picking up speed in the Northeast and Midwest, while sales in the West and South were sluggish. In the Northeast, sales of existing homes jumped 7.0 percent to an annual rate of 610 thousand units. After falling for three consecutive months, sales in the Midwest rose moderately by 2.3 percent to an annual rate of 890 thousand units. In the South, sales remained unchanged at an annual rate of 1.27 million units. The West was the only region to experience a decline in April, where sales dropped 7.5 percent to an annual rate of 620 thousand units, even with the sales rate of a year ago, and slower than any rate since then.

SINGLE-FAMILY HOME PRICES

	Median		Average	
	Existing	New	Existing	New
Apr 1989	$93,500	117,000$	$118,200	145,700$
Mar 1989	92,000	126,000	116,100	150,500
Feb 1989	91,900	119,000	117,800	147,000
Jan 1989	89,700	113,000	113,000	138,600
Dec 1988	88,700	121,000	112,000	147,700
Apr 1988	$88,000	111,000$	$109,600	135,600$
1988	89,300	112,500	112,800	138,200
1987	85,600	104,500	106,300	127,200
Apr 1989 Changes From:				
Mar 1989	1.6%	-7.1%	1.8%	-3.2%
Apr 1988	6.4%	5.4%	7.8%	6.7%

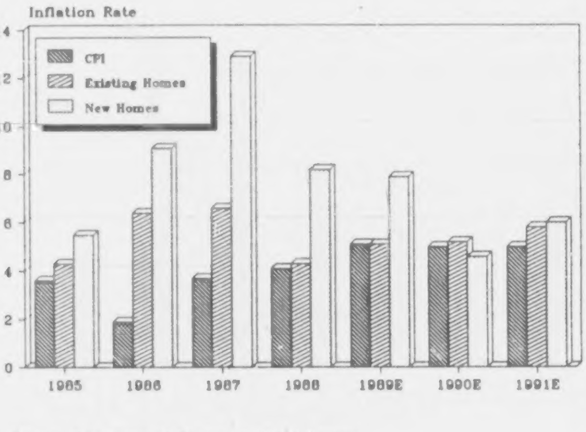
REGIONAL DATA

MEDIAN SALES PRICE OF AN EXISTING HOME

	Northeast	Midwest	South	West
Apr 1989	$144,300	$70,500	$86,100	$140,700
Mar 1989	143,600	69,900	84,000	138,000
Feb 1989	142,600	69,900	86,700	127,800
Jan 1989	143,800	67,800	82,400	130,700
Dec 1988	143,000	67,700	78,200	128,700
Apr 1988	$141,000	$67,600	$81,000	$117,700
1988	143,000	68,400	82,200	124,900
1989	133,300	66,000	80,400	113,200
Apr 1989 Change From:				
Mar 1989	0.5%	0.9%	2.5%	2.0%
Apr 1988	2.3%	4.3%	6.3%	19.5%

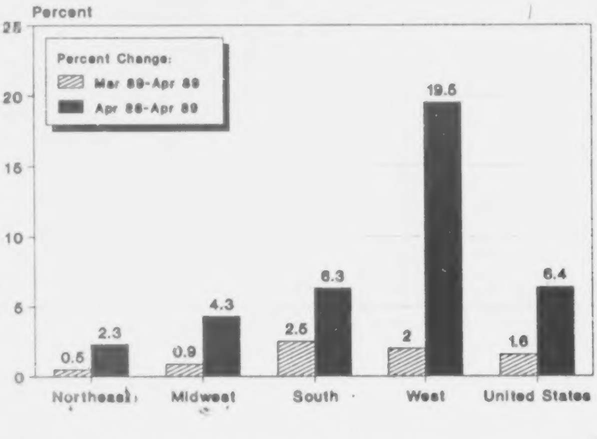
Source: NATIONAL ASSOCIATION OF REALTORS®, Economics and Research Division

GRAPH 13: HOME PRICES



Source: The Bureau of Census; E NAR Estimates

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics and Research; E NAR Estimates

The median price of an existing single-family home rose 1.6 percent in April to $93,500, marking the fifth consecutive monthly advance. Meanwhile, the sales price of a new single-family home plunged 7.1 percent to $117,000. Much of the April movement in home prices can be traced to regional shifts in sales. While sales of new homes increased, sales declined in the Northeast, the highest priced region in the country, and rose dramatically in the South, where the median home price is less than the national median. Exactly the opposite was true for sales of existing homes, with sales rising 7.0 percent in the Northeast and remaining unchanged in the South.

While the Northeast continues to retain its position as the highest priced region of the country, the West may take over this title before the end of this year. In the year ending April 1989, the median price of an existing single-family home rose 19.5 percent to $140,700, while home prices in the Northeast increased by only 2.3 percent to $144,300. Home prices in the South have been showing renewed strength in recent months, rising 2.5 percent in April to $86,100. In the Midwest, prices continue to show moderate, steady growth rising 0.9 percent in April, and 4.3 percent for the year, to $70,500.

Sean A. Burns,
Director of Forecasting
Beth M. Maerz,
Research Associate

PROSPECTIVE FIRST-TIME HOMEBUYERS: THEIR CHANGING FINANCIAL POSITIONS

House prices, household incomes, household savings and wealth, monthly housing expenses, mortgage interest rates, mortgage instruments, and loan underwriting criteria -- each is a dimension of housing affordability, most of whose trends are discussed in the November 1988 *Outlook for the Economy and Real Estate* article, "Explaining Trends in Homeownership."[1] Each of these dimensions can be placed into two broad aspects of the affordability of homeownership -- the ability of a household to make the transition to homeownership and the ability of a household to meet the ongoing expenses of homeownership. Here, as in the April *Outlook* article, "The Assets of Prospective First-time Homebuyers: A Look at the 1983 and 1986 Surveys of Consumer Finances," we will address the former -- the ability of a renting household to make the transition to homeownership.

In April's issue, we looked at the characteristics which truly make a "potential" first-time homebuyer "prospective." Simply put, our "potential" first-time homebuyer is a household which has never owned a home (based on assumptions laid out in the previous article.) Moreover, the median age of the first-time homebuyer remains between 25 and 34 years, and accordingly we limited our potential first-time homebuyers to renting households within this age group. We further limited our potential first-time homebuyers to those with incomes sufficient to meet the ongoing expenses of homeownership. Because we found a disproportionately large share of renting households relative to homeowners (ages 25 through 34) with low incomes, we further constrained our sample to renting households with 1985 incomes of $20,000 or more. This is our target group, referred to as "prospective first-time homebuyers."

Throughout the April article, the financial and real assets of the samples of "prospective first-time homebuyers" were compared to those of "first-time homeowners" and "non first-time homeowners," similarly constrained by age and income. A sample of "non first-time homeowners," unconstrained by age and income, was included in the tables but was not discussed. This article will be structured in a similar manner. However, in contrast to the previous article in which we looked at the median values for those households holding each asset type, we will look primarily to average values for all households. Moreover, unlike the last article the data will be weighted by Federal Reserve computed weights.[2]

The Assets and Liabilities of Prospective First-time Homebuyers

The ability to meet the ongoing expenses of homeownership is best explained by the current income, education and vocational training, profession, etc. (as proxies for "lifetime earnings") of a household. However, the ability to make the transition to homeownership is best explained by the stock concepts of household wealth and savings.

In "The Assets of Prospective First-time Homebuyers," we saw that only small percentages (less than one-third in many cases) of young households -- prospective first-time homebuyers, first-time homeowners and non first-time homeowners alike -- held assets other than checking and savings accounts and vehicles. Table 1 shows both the average 1986 dollar holdings and the percentage of households holding each asset type.[3] For 7 asset types, prospective first-time homebuyers have lower average 1986 values than both first-time and non first-time homeowners of similar age and income. These include bonds, IRA and Keogh accounts, money market accounts/CDs, cash value of life insurance, "other" financial assets, non primary residence real estate and vehicles. Additionally, the average value of liquid assets, or those most easily converted to a home equity downpayment, of prospective first-time homebuyers is only 78% and 71% of the liquid assets of first-time and non first-time homeowners, respectively.

On the other hand, the average values of stocks and mutual funds, checking and savings accounts, profit sharing and thrifts and business assets of prospective first-time homebuyers are greater than those of first-time homeowners but less than those of non first-time homeowners. This shortfall of first-time homeowners may reflect the liquidation of some assets by the first-time homeowners for the home purchase, while the non first-time homeowners have had time to replenish the savings they may have used for a home downpayment. On average, total assets (excluding the current value of primary residences of homeowners) of prospective first-time homebuyers was below that of both groups of comparable homeowners -- $31,752 vs. $40,560 and $44,475. When the current value of the primary residences of the homeowners is included, the gap widens substantially -- $31,752 vs. $121,181 and $114,670, respectively.

Liabilities are also an important component of the affordability of homeownership. Even if a prospective first-time homebuyer believes that he/she can take on the burden of a mortgage, the lender may feel otherwise, particularly in light of recent high rates of delinquency and foreclosure. The debt outstanding of prospective first-time homebuyers appears to be, on average, lower than that of the comparable homeowners. (See Table 2.) In fact, the average 1986 debt (excluding mortgage debt on primary residences for homeowners) of non first-time homeowners was 43% higher and that of first-time homeowners was

TABLE 1

1986 Financial and Real Assets
Average 1986 dollar values (and percent of households holding)* for:

	Prospective First-Time Homebuyers	First-Time Homeowners	Non First-Time Homeowners	Non-First Time Homeowners (all ages & income)
FINANCIAL				
Stocks and Mutual Funds	$790(27.4%)	$756(25.3%)	$904(18.9%)	$21,695(23.7%)
Bonds	208(14.5)	1,256(27.0)	1,268(29.7)	8,457(25.7)
Checking and Savings Acct	3,668(100.0)	3,157(98.9)	4,133(98.2)	8,054(95.2)
IRA and Keogh Accts.	1,126(20.0)	1,427(35.5)	1,300(30.0)	7,745(34.3)
Money Market & CD's	1,678(21.9)	3,014(25.7)	2,683(24.5)	12,435(35.2)
Profit Sharing and Thrift Accounts	1,237(27.9)	1,180(26.1)	2,240(25.8)	5,855(16.6)
Life Insurance, cash value	987(20.1)	1,563(31.4)	4,881(34.7)	5,157(43.4)
Other Financial Assets	9(0.4)	278(2.2)	330(3.7)	8,637(6.8)
Liquid Assets**	6,345	8,183	8,988	50,641+
REAL				
Real Estate, other than primary residence	9,813(15.1)	10,670(15.1)	10,299(18.9)	38,081(28.2)
Business Assets	5,361(4.5)	4,990(12.6)	7,915(19.2)	39,685(16.4)
Vehicles	6,875(93.0)	12,269(99.0)	8,523(100.0)	8,238(92.0)
TOTALS				
Total Financial Assets***	9,703	12,631	17,739	78,035
Total Real Assets****	22,049	27,929	26,736	86,004
Total Assets*****	31,752	40,560	44,475	164,039
Current Value of Primary Residence	0	80,621	70,195	81,770
Total Assets******	31,752	121,181	114,670	245,809

*All values are weighted by Federal Reserve Board computed weights.

**Liquid assets is the average over all households of the sum of stocks and mutual funds, bonds, checking and savings accounts and money market accounts and CDs for each household.

***Total financial assets is the average over all households of the sum of the 8 financial assets in the Table, except liquid assets which is composite of several assets, for each household.

****Total real assets is the average over all households of the sum of the 3 real assets in the Table for each household. Please note this excludes the current value of primary residences for homeowners.

*****This is the average value over all households of the sum of the 8 financial and 3 real assets of the Table for each household. Please note this excludes the current value of primary residences for homeowners.

******This is the average value over all households of the sum of the 8 financial and 3 real assets and current market value of primary residences for each household. The inclusion of the current value of primary residences substantially increases the total assets of homeowners.

SOURCE: NATIONAL ASSOCIATION OF REALTORS® tabulations of 1986 Survey of Consumer Finances, Federal Reserve Board.

TABLE 2

1986 Debt Outstanding

Average 1986 dollar values*
(and percent of households having) for

	Prospective First-time Homebuyers	First-time Homeowners	Non First-time Homeowners	Non First-time Homeowners (all ages & incomes)
Mortgage Debt, properties other than primary residence	$871 (2.9%)	$5,043 (12.4%)	$3,036 (6.8%)	$9,358 (11.5%)
Installment Debt, loans for additions and repairs to home	0 (0.0)	378 (8.0)	455 (9.4)	375 (6.6)
Installment Debt, automobile, truck and vehicle loans	1,905 (37.8)	4,875 (45.3)	2,066 (41.0)	1,495 (24.8)
Installment Debt, furniture, appliance, recreation, or hobby loans	33 (5.3)	231 (13.9)	134 (11.3)	106 (6.9)
Installment Debt, "other" loans with regular payments	1,668 (20.0)	512 (23.0)	871 (16.9)	472 (11.7)
Nonregular Payment Consumer Installment Debt	391 (13.2)	288 (7.6)	250 (6.2)	766 (7.2)
Credit Card Debt	530 (46.9)	1502 (62.0)	912 (63.6)	689 (46.6)
Total Debt**	5,398	12,829	7,725	13,261
Mortgage Debt (first and second mortgages) on Primary Residence	0(0.0)	54,051 (91.7)	35,170 (93.2)	18,339 (55.9)
Total Debt***	5,398	66,880	42,895	31,600

* All values are weighted by Federal Reserve Board computed weights.

** This total debt does not include the debt outstanding (first and second mortgages) on primary residences, whose inclusion substantially increases the total dollar value of debt outstanding for the homeowners. Total debt is the average over all households of the sum of the 4 debt types of the Table for each household.

*** This includes the debt outstanding (first and second mortgages) on primary residences for homeowners. Total debt is the average over all households of the sum of the 8 debt types of the Table for each household.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®, tabulations of the 1986 Survey of Consumer Finances, Federal Reserve Board.

TABLE 3

1986 Balance Sheets

Average 1986 values* for:

	Prospective First-Time Homebuyers	First-Time Homeowners	Non First-Time Homeowners	Non First-Time Homeowners (All ages & incomes)
EXCLUDING CURRENT VALUE OF PRIMARY RESIDENCE AND DEBT THEREUPON				
Total Assets	$31,752	$40,560	$44,475	$164,039
Total Debt	$5,398	$12,829	$7,725	$13,261
Net Worth	$26,354	$27,731	$36,750	$150,778
INCLUDING CURRENT VALUE OF PRIMARY RESIDENCE AND DEBT THEREUPON				
Total Assets	$31,752	$121,181	$114,670	$245,809
Total Debt	$5,398	$66,880	$42,895	$31,600
Net Worth	$26,354	$54,301	$71,775	$214,209

* All values are weighted by Federal Reserve Board computed weights.

SOURCE: NATIONAL ASSOCIATION OF REALTORS® tabulations of the 1986 Survey of Consumer Finances, Federal Reserve Board.

two and one third times higher than the 1986 debt of prospective first-time homebuyers -- $7,725 and $12,829 vs. $5,398. Prospective first-time homebuyers, on average, had less mortgage debt on real estate other than primary residences, less credit card debt and less regular payment consumer installment debt on automobile, truck and vehicle loans, furniture, appliance, recreation and hobby loans. In contrast, prospective first-time homebuyers had, on average, over three and two times the amount of "other" regular payment installment debt, such as loans for education and medical expenses, than first-time and non first-time homeowners, respectively.

Table 3 summarizes the 1986 wealth of prospective first-time homebuyers vis-a-vis the other household types. When the current value of the primary residences of the homeowners and debt thereupon is not considered, the difference in the net worth of prospective first-time homebuyers and first-time homeowners is small, $26,354 vs. $27,731. However, when the current value of the primary residences of homeowners net of the mortgage debt is considered, the difference in the net worth of prospective first-time homebuyers and first-time homeowners widens substantially -- $26,354 vs. $54,301.

How Do They Save?

A sample of first-time homebuyers from the National Association of REALTORs' 1986 Homeownership Survey indicated that on average, the largest share (64%) of the home downpayment came from personal savings. Table 4 gives us an idea of how the 32.0% of prospective first-time homebuyers indicating that their primary reason for saving was to buy their own homes (from the 1986 Survey of Consumer Finances) actually saved. First, prospective first-time homebuyers saved more in financial assets between 1983 and 1986, $9,141 compared to $6,431 for first-time homeowners and $5,998 for the non first-time homeowners. Moreover, those prospective first-time homebuyers saving for a home appeared interested in the liquidity of their financial assets. While the average change from 1983 to 1986 in liquid assets of the young renting households saving for their first homes was $5,390 ($3,825 of which represented growth in checking and savings -- the most liquid asset type), the growth in liquid assets was only $3,819 for first-time homeowners and $3,216 for comparable non first-time homeowners. One could conjecture that the young first-time homeowners were in a "rebuilding period," much of their liquid savings having gone toward home downpayments and closing costs.

Prospective first-time homebuyers also appeared to be cautious about incurring debt while saving for homes. (See Table 4.) On average, their consumer installment debt increased by only $44 over the 1983 to 1986 period; whereas, first-time homeowners' installment debt rose by $3,553. On average, non first-time homeowners actually reduced their consumer installment debt by $495 over the 3-year period. Similarly, while the average credit card balances of young first-time and non first-time homeowners increased by $1,191 and $470 from 1983 to 1986, prospective first-time homebuyers' credit card balances increased by just over $300. The large increase in the credit card balances of first-time homeowners may reflect the "payment shock" often experienced by new homeowners.

Conclusion

The evidence suggests that many renting households strongly desire homeownership, with nearly one-third of prospective first-time homebuyers from the 1986 Survey of Consumer Finances indicating this as their primary reason for saving. Many seem to be trying to better position themselves financially for the transition, as evidenced by increasing asset balances, particularly liquid asset balances, and declining loan and credit card balances. In some housing markets, these measures will probably make homeownership a reality for many renting households with sufficient resources to meet the ongoing expenses of homeownership; but in many other markets, such measures will be insufficient and homeownership will be denied, or at least deferred, for many households.

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1.Excellent sources on homeownership affordability include David A. Crowe and Douglas B. Diamond, Jr., "Trends in Homeownership: 1980 to 1985," paper prepared for AREUEA/AEA meeting, Dec. 1985 and William C. Apgar, Jr. and H. James Brown "State of the Nation's Housing: 1988," prepared for the Joint Center for Housing Studies of Harvard University.

2.For a complete discussion of the development of the 1986 sample weights, see Robert B. Avery and Arthur B. Kennickell, Board of Governors of the Federal Reserve System, 1986 Survey of Consumer Finances: Technical Manual and Codebook.

3.The percentage of households holding each asset type reported here may differ from that reported in Table 2 of the April Outlook for the Economy and Real Estate article, "The Assets of Prospective First-time Homebuyers: A Look at the 1983 and 1986 Surveys of Consumer Finances." The reason for the divergence is that while we compared the percentages of unweighted samples in that article, the samples are weighted here to reflect the true 1986 population.

TABLE 4

Households' Changing Financial Positions

	Prospective First-time Homebuyers*	First-time Homeowners	Non First-time Homeowners	Non First-time Homeowners (all ages-incomes)
Average Changes in values from 1983 to 1986 in the following:				
FINANCIAL ASSETS				
Stocks and Mutual Funds	$290	$229	$456	$4,694
Bonds	3	388	144	2,387
Checking and Savings Accts.	3,825	1,452	1,853	3,251
Money Market and CDs	1,272	1,750	763	2,379
Total Liquid Assets	5,390	3,819	3,216	12,711
IRAs and Keogh Accts.	1,201	1,326	863	4,977
Profit Sharing and Thrifts	2,183	1,084	1,629	3,058
Life Insurance, Cash Value	427	319	538	441
Other Financial Assets	(60)	(117)	(248)	2,415
Total Nonliquid Assets	3,751	2,612	2,782	10,891
TOTAL FINANCIAL ASSETS	9,141	6,431	5,998	23,602
REAL ASSETS				
Home	0	80,621	19,254	13,269
Other Real Estate	12,323	5,145	4,606	11,775
Business Assets	$18,134	$2,579	$2,482	$174
Vehicles	2,201	8,031	2,765	2,604
TOTAL REAL ASSETS	32,659	96,376	29,107	27,822
TOTAL ASSETS	41,800	102,807	35,105	51,424
REAL ESTATE DEBT				
Home Mortgages, First & Second	0	54,051	10,243	2,702
Mortgages on other real property first and second mortgages	(729)	2,795	1,482	4,128
TOTAL REAL ESTATE DEBT	(729)	56,846	11,725	6,830
CONSUMER INSTALLMENT DEBT				
Regular payment debt	1,439	3,829	186	292
Nonregular payment debt	(1,395)	(276)	(681)	(1,031)
TOTAL CONSUMER INSTALLMENT DEBT	44	3,553	(495)	(739)
CREDIT CARD DEBT	307	1,191	470	278
TOTAL DEBT	(378)	61, 590	11,700	6,369
NET WORTH	42,178	41,217	23,405	45,055

* This category only includes "prospective first-time homebuyers" as previously defined who expressed that their primary reason for saving is to buy a house.

SOURCE: NATIONAL ASSOCIATION OF REALTORS® tabulations of 1986 Survey of Consumer Finances, Federal Reserve Board.

U.S. ECONOMIC OUTLOOK

JUNE 1989

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	88.4	89.1	89.2	89.3	89.4	90.1	90.2	90.3	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5000	5105	5193	5268	5346	5437	5515	5595	4527	4864	5228	5556	5907
% Change	7.6	8.7	7.1	5.9	6.1	7.0	5.9	6.0	6.8	7.5	7.5	6.3	6.3
% Change (w/out inflation)	2.4	4.3	2.2	2.3	1.5	1.9	1.6	1.7	3.4	3.9	2.8	1.8	1.9
Consumer Price Inflation (CPI)	4.4	5.4	6.2	3.9	5.1	5.1	4.9	4.9	3.7	4.1	5.1	5.0	5.0
GNP Inflation (GNP Deflator)	5.3	3.9	4.9	3.5	4.5	4.9	4.2	4.2	3.3	3.4	4.5	4.4	4.4
Unemployment Rate - Civilian	5.3	5.2	5.3	5.2	5.2	5.3	5.3	5.4	6.2	5.5	5.2	5.4	5.5
Civilian Employment-Household Basis (millions)	115.8	116.9	117.4	117.8	118.3	118.6	118.8	119.1	112.4	115.0	117.6	119.0	120.3
Percent change	2.2	3.7	1.6	1.6	1.5	1.0	1.0	0.9	2.6	2.3	2.3	1.2	1.1
Index of Industrial Production	139.9	140.6	141.4	142.7	143.4	144.2	144.8	145.4	129.8	137.2	142.0	145.0	147.4
Manufacturing Capacity Utilization	84.4	84.3	83.7	84.0	83.9	83.7	83.5	83.3	81.0	83.6	84.0	83.4	82.5
Domestic Auto Sales	7.5	6.9	7.3	7.0	7.1	7.1	7.1	7.1	7.1	7.5	7.1	7.1	7.0
Federal Tax Receipts (NIPA) as % of GNP	19.8	20.5	21.1	21.4	21.8	22.5	22.8	23.2	18.3	19.5	21.2	23.0	24.6
Federal Expenditures (NIPA) as % of GNP	23.0	23.7	23.7	24.0	24.3	24.8	25.1	25.4	21.5	22.4	23.9	25.3	26.7
Deficit(NIPA)	-157.5	-158.5	-130.8	-130.1	-125.9	-114.8	-112.3	-109.8	-157.8	-142.4	-136.3	-111.2	-105.7
as % of GNP	-3.2	-3.1	-2.5	-2.5	-2.4	-2.1	-2.0	-2.0	-3.5	-2.9	-2.6	-2.0	-1.8
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4877	4516	4494	4527	4469	4318	4414	4453	4648	4651	4501	4400	4459
Percent change – year ago	9.7	-2.0	-3.8	-3.5	-8.4	-4.4	-1.8	-1.6	-1.4	0.1	-3.2	-2.2	1.3
Existing Single-family Home Sales (thousands)	3773	3477	3480	3535	3475	3335	3415	3455	3526	3594	3492	3405	3455
Percent change – year ago	11.3	5.4	-4.5	-3.5	-7.9	-4.1	-1.9	-2.3	-1.1	1.9	-2.8	-2.5	1.5
Housing Starts (thousands)	1559	1514	1425	1418	1417	1397	1419	1421	1634	1496	1443	1416	1419
Percent change – year ago	1.7	2.5	-3.7	-3.3	-9.1	-7.7	-0.4	0.2	-9.8	-8.5	-3.5	-1.9	0.2
Single-Family Units	1138	1071	1045	1022	1025	1013	1030	1029	1157	1089	1041	1026	1035
Percent change – year ago	4.5	-2.3	-1.6	-3.6	-10.0	-5.4	-1.4	0.6	-2.2	-5.8	-4.5	-1.4	0.9
Multi-Family Units	420	443	380	395	392	384	389	392	477	406	403	390	384
2-4 Family Units	65	60	51	53	53	52	52	53	66	59	54	53	52
Percent change – year ago	16.0	5.9	-10.7	-6.5	-19.1	-13.3	2.4	-0.9	-22.6	-10.3	-8.0	-3.2	-1.5
5 + Family Units	355	383	329	342	339	332	336	339	412	347	348	337	332
Percent change – year ago	-8.2	18.3	-9.0	-2.0	-4.4	-13.3	2.4	-0.9	-24.4	-15.7	0.3	-3.2	-1.5
New Single-family Home Sales (thousands)	679	628	651	667	605	570	585	607	671	677	638	587	644
Percent change – year ago	9.3	-0.3	-6.6	-5.1	-10.9	-9.2	-10.1	-9.0	-10.5	0.9	-5.8	-8.0	9.7
Mobile Homes Shipped (thousands)	223	217	218	204	207	205	209	212	233	217	212	211	233
HOME PRICES													
Existing Home Prices - Median $(1000)	88.7	91.2	94.0	94.7	95.6	96.6	98.0	99.3	85.6	89.3	93.9	98.8	104.5
Percent change – year ago	4.4	3.9	5.7	5.0	7.8	5.9	4.3	4.9	6.6	4.3	5.1	5.2	5.8
New Home Prices - Median $(1000)	114.9	119.3	119.8	121.0	125.4	127.5	125.1	126.2	104.0	112.5	121.4	126.9	134.5
Percent change – year ago	2.8	5.7	6.1	5.3	9.1	6.9	4.4	4.3	13.0	8.2	7.9	4.6	6.0
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.6	10.9	10.6	10.6	10.5	10.5	10.4	10.4	10.2	10.5	10.7	10.4	10.3
1-year ARM (without buydown)	8.5	8.8	9.0	8.7	8.5	8.5	8.5	8.4	8.5	8.5	8.8	8.5	8.6
Corporate AAA Bond Rate	9.5	9.7	9.5	9.4	9.3	9.3	9.2	9.2	9.4	9.7	9.5	9.2	9.3
Government Bond Rate	9.0	9.0	8.8	8.6	8.5	8.4	8.4	8.4	8.6	9.0	8.8	8.4	8.5
Short-Term Interest Rates													
Federal Funds Rate	8.5	9.4	9.9	9.7	9.4	9.0	8.7	8.5	6.7	7.6	9.6	8.7	8.9
3-month T-Bill Rate	7.7	8.5	8.6	8.4	8.1	7.9	7.6	7.5	5.8	6.7	8.4	7.6	7.8
Prime Rate	10.2	11.0	11.6	11.4	11.0	10.8	10.5	10.3	8.2	9.3	11.3	10.4	10.7
Discount Rate	6.5	6.7	7.0	7.1	7.1	6.9	6.7	6.5	5.7	6.2	7.0	6.6	6.5
Value of the U.S. Dollar (Trade-Weighted Avg.)	93.0	96.0	100.6	102.1	98.5	95.3	93.3	91.9	96.9	92.8	99.3	92.7	86.8
Percent change	-17.6	13.5	20.8	5.9	-13.1	-12.6	-8.0	-6.0	-13.6	-4.3	7.0	-6.6	-6.3

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz.

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Vol. 2, No. 7

July 1989

OUTLOOK

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The U.S. Department of Commerce released its second revision to first quarter real GNP growth, nudging the estimate 0.1 percent higher to 4.4 percent. Without the drought-related adjustment to farm output of 2.5 percentage points, real non-farm GNP advanced at a sluggish 1.9 percent annual rate.
- Despite a fall in the unemployment rate in May from 5.3 percent to 5.2 percent, non-farm businesses added the smallest monthly total of new employees in over 3 years, with payrolls expanding by a mere 101,000 employees. This decline was centered mainly in the goods-producing industries where total employment dropped by 33,000 employees.
- A rally in the bond market brought substantial relief to the mortgage market, with fixed rate mortgages falling below 10 percent at many lending institutions for the first time in fifteen months.
- Housing starts of privately owned homes fell for the fourth consecutive month in May to a seasonally adjusted annual rate of 1.31 million units, the lowest rate in seven years. The decline in starts was brought on primarily by a decline in the construction of single-family homes, which slid 4.6 percent to an annual rate of 980 thousand units.
- After rising 9.1 percent in April, sales of new single-family homes rose an additional 2.7 percent in May to a seasonally adjusted annual rate of 613 thousand units. Despite the recent pickup, sales of new homes are still well below the rate of 1988.
- Sales of existing single-family homes slid 5.9 percent in May to a seasonally adjusted annual rate of 3.21 million units, putting sales 11.3 percent below the 3.62 million unit annual rate of a year ago.
- The median sales price of an existing single-family home inched up 0.2 percent in May to $93,100, marking a modest 3.9 percent increase over the $89,600 median price of a year ago. The median price of a new single-family home jumped 7.7 percent over the April median price, and 13.6 percent above that of a year ago, to $125,000 in May.

IN THIS ISSUE

REALTOR®

Forecasting & Policy Analysis Division
NATIONAL ASSOCIATION OF REALTORS ®
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The Hare-Brained Economy
Economic Commentary

by
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Chief Economist
and Senior Vice President
Real Estate Finance

The icons are falling. First, the University of Kentucky basketball program is closed down for three years. Then, Jim Wright is driven from the Congress in a process most reminiscent of a bear-baiting. And, to show that events (good or bad -- you make the call) happen in threes, Barry Switzer resigns from the throne of Oklahoma University. In part, one wonders whether the system of reward and punishment used in these cases should be consistent. For example, if a Congressman or Senator is proven to have committed an offense twice, should the district or state represented revert to territorial status (analogous to the NCAA "death penalty" of closing down an athletic program)? But, over and above that concern, these events provide an object lesson in how the U.S. economy has changed and continues to change.

The common denominator in these three episodes is money. In short, it became economically feasible to do the morally unfeasible--breaking the essential rules of conduct--because big bucks beckoned. It was not too long ago that Speakers of the House (even people like Sam Rayburn) or football coaches (like Pat O'Brien...er, Knute Rockne) labored in obscurity. But the growing centrality of the Federal government in all our lives has opened up cash channels for ordinary legislators. And the amount of attention we pay to television has made college sports a big-time business. So the misfortunes of the great, while primarily their own fault, were set up by a shift in economic values and incentives.

Even in business, the prominent figures (I dare not use the term "heroes") no longer make cars or steel or produce petroleum products. Today Ford, Carnegie and Rockefeller are Donald Trump and Carl Icahn, guys who make deals, not sedans. And while Lee Iaccoca may be put up as an exception, Chrysler makes more of its profit from financing cars than it does from making them.

All this is the product of the incentive systems permeating our society and our economy. Reward structures have become increasingly short-term in focus, to the benefit of consumption activities at the expense of building for the future. Government service is no longer viewed as a long-term career, as it is in Japan or Europe, but a two-year steppingstone to big consulting contracts. Moreover, even those business activities that do have the appearance of long-term arrangements are less value-adding and more on the order of rearranging the deck chairs. The common mode (see Lorenzo, Frank) of business dealing these days is to acquire through debt financing and then sell off assets to redeem debt. And while this decentralization of operations in some cases can increase efficiency, its real end is the making of a quick and substantial profit.

For consumers, the changes in economic life are best typified by the emphasis on short-term gratification. We want what we want when we want it, and if achieving that requires spending more than we earn, so be it. The patience to build for the future is weaker, the desire to get it now stronger. I think we in real estate are beginning to see this take hold quite strongly. Rising house prices combined with a disappearing savings discipline are persuading young families that it's more reasonable to spend $250 for a new VCR than to put that money toward a down payment. Later this year, we'll see how deeply the mind set has become: falling rates are likely to trigger only a modest rally in residential numbers.

The incentive system has its dark side as well. Part of the reason why drug trafficking is such an enormous and intractable problem is economics. Our desires for instant gratification provide a steady consumption demand. On the other side, the lure of quick money now generates a steady flow of workers to the drug industry. In a more forward-looking economy, the big bucks would seem far less attractive because they would be balanced by the probability of a short life span. But longevity holds less and less value in our system.

All this puts us at a substantial disadvantage relative to our industrial rivals. The Japanese are firmly focussed on the long term and are building steadily toward it; the coming European unification will revitalize those economies and, in doing so, stimulate investment. To a real extent, we are courting the fate of Aesop's hare, who having achieved much, got lost in his own excellence and eventually lost it all.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

The U.S. Department of Commerce released its second revision to real GNP growth, nudging the estimate 0.1 percent higher to 4.4 percent. Without the drought-related adjustment to farm output of 2.5 percentage points, real non-farm GNP advanced at a sluggish 1.9 percent annual rate. The Commerce Department made a more substantial revision to its GNP price index, which monitors price changes on a fixed basket of goods and services. Originally estimated at 5.0 percent, the rise in the price index now stands at a more modest 4.6 percent in the first quarter. However, prices in the first quarter were still climbing faster than the 4.2 percent pace in the final quarter of 1988. The first quarter GNP revision was released amidst a slew of monthly reports on the state of the economy in May which suggest that a slowdown is underway: a large drop in durable goods orders, sluggish retail sales and consumer spending, and lackluster employment growth. The May data further illusrates that, despite an uptick in economic activity during April, the pace of growth has slowed so far in 1989. For all of 1989, real GNP growth is forecast to reach 2.8 percent, down from 3.9 percent in 1988.

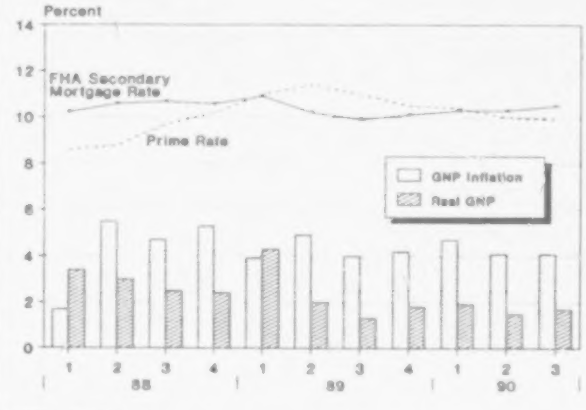
Employment Growth is on the Decline

Despite a fall in the unemployment rate in May from 5.3 percent to 5.2 percent, non-farm businesses added the smallest monthly total of new employees in over 3 years, with payrolls expanding by a mere 101,000 employees. This decline was centered mainly in the goods producing industries where total employment dropped by 33,000 employees. While a low unemployment rate generally signals economic health, slow employment growth can lead to slower output growth, assuming no significant increase in productivity. Mixed reviews followed the release of the employment report. as most analysts had expected employment growth to be almost twice as strong. Some sang the now familiar song that the Federal Reserve has tightened credit too far drawing a recession dangerously close. On a more optimistic note, some analysts cited the report as evidence that the Fed has successfully engineered a "soft-landing"-slower economic growth with less inflationary pressures. If so, the Federal Reserve may now be able to loosen credit even further.

Manufacturing Activity on the Decline

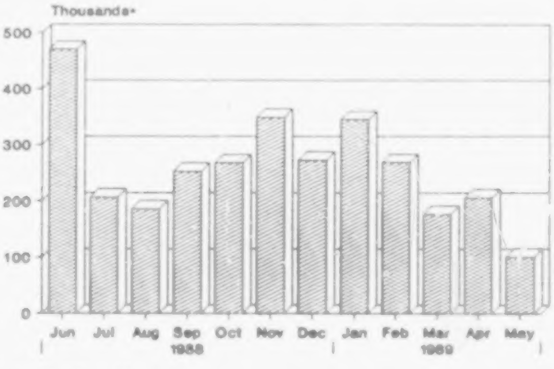
Further signs of weakness came from a drop in the Purchasing Managers' Index, collected by the National Association of Purchasing Managers. May data for the index showed an overall decline in manufacturing for the first time in three years. The index measures manufacturing performance based on a survey which tracks new orders, production, vendor deliveries, inventory and employment. A number above 50% generally indicates economic growth while below 50% shows just the opposite; the May report showed the index falling to 49.7%. However, despite the decline, there appeared to be some optimism in the report, especially for those who are hoping for a "soft-landing." Export orders remained relatively strong despite a higher dollar, vendor deliveries picked up, and commodities reported in short supply dropped to their lowest level in 30 months, indicating that bottlenecks may be subsiding.

GRAPH 1: THE ECONOMIC OUTLOOK



E NAR estimates

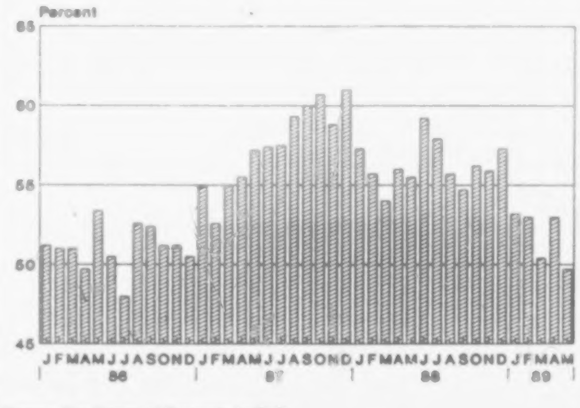
GRAPH 2: EMPLOYMENT GROWTH SLOWS



*Seasonally adjusted increase in non-farm employment.

Source: Bureau of Labor Statistics

GRAPH 3: SURVEY OF PURCHASING MANAGERS SHOWS DECLINE IN MANUFACTURING ACTIVITY



Source: The Bureau of Economic Analysis

Rising Inflation Is Met With Moderate Concern

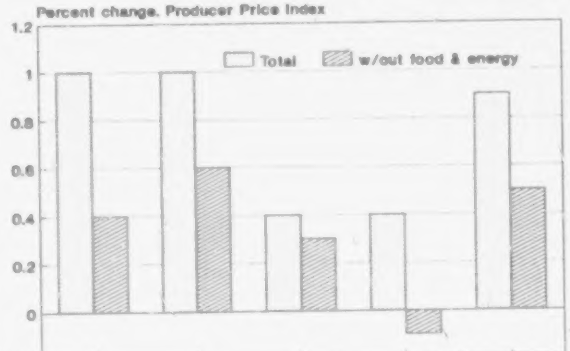
For over a year, reports of monthly price rises in excess of 0.4 percent have engendered a great deal of inflationary concerns. Until recently the Fed has fought to control these increase through a tight monetary policy. Only over the last several weeks has the Fed begun to relax its tight grip on the money supply. As evidence that both the Fed and financial market players sense cooler days ahead on the inflation front, there was little reaction to the rather sizable increase in the May producer price index (0.9%) and the consumer price index (0.7%). Given that a decline in inflation generally lags slower economic growth, the consensus is that price pressures will recede in coming months, and further increases in interest rates would only risk a recession. In addition, large jumps in the cost of food and energy have tended to exaggerate the rate of inflation throughout 1989. As Graph 5 illustrates, without these two components the rate of inflation for the past 5 months has been considerably slower. Oil prices, which have risen 50 percent in 1989, have been expected to ease in the second half of the year, while food prices stabilize. However, in the past month OPEC has been successful in securing pledges of lower monthly production from both Kuwait and the United Arab Emirates which could reduce oil production this summer by more than one million barrels a day, resulting in a continued firming in oil prices. If this is the case, expectations of substantially lower rates of inflation in the second half of 1989 may be a bit premature.

MONETARY POLICY AND INTEREST RATES

As both the Federal Reserve and financial markets appear to be assuaged by the signs of slower economic growth and the hopes of lower energy costs, interest rates have continued to slide. The move towards lower interest rates during July began with a half percentage point fall in the prime rate, the first decline in over a year. The prime rate has a strong bearing on a variety of consumer and business loans, and many banks use this as a base when calculating adjustable-rate home-equity loans. Meanwhile, encouraged by signs of a trend towards a looser credit policy, long-term rates have continued to fall, as investors, both domestic and foreign, showed considerable interest in the bond market. The result has been almost a 70 basis point drop in the rate on a 30-year Treasury bond in the past month. We expect that the bond rate, now at 8.3 percent, has probably hit its low point for the year, rising slightly in the later months to around 8.8 percent.

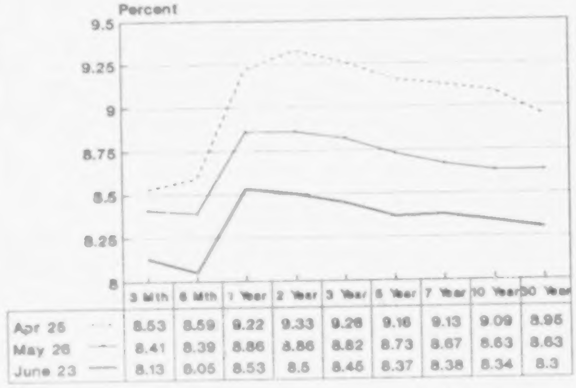
The recent rally in the bond market has offered substantial relief to the mortgage market, with fixed rate mortgages falling below 10 percent at many lending institutions for the first time in fifteen months. During the first two weeks of June, some lending institutions dropped their rates by as much as a full percentage point. As a result, lenders across the country have reported a step up in lending activity, as homebuyers are drawn into the market by the attractive lower rates and homeowners rush to refinance mainly adjustable rate loans, some of which have gone higher than 13 percent in the past few months. Given that lenders are becoming far more reluctant to offer the heavily discounted ARMs which became popular last year, the decline in fixed rate mortgages couldn't have come at a better time. Moreover, as high short-term rates have narrowed the spread between adjustable and fixed rates in recent months, homebuyers are showing a new-found preference towards fixed rate mortgages.

GRAPH 4: RISING ENERGY COSTS PUSH PRODUCER PRICES HIGHER



Source: The Bureau of Labor Statistics.

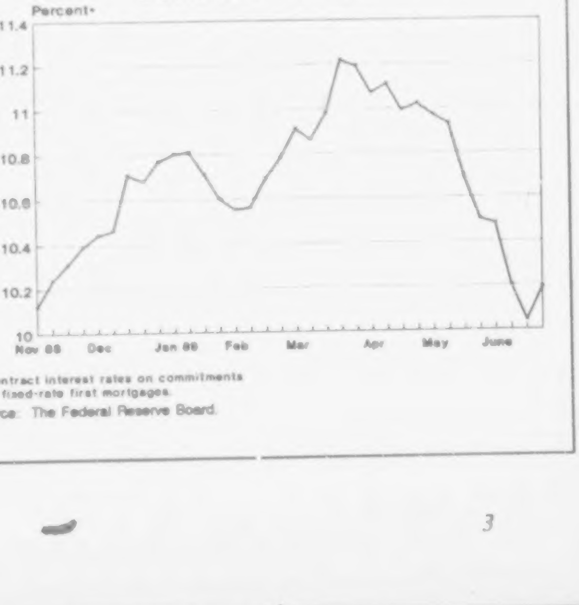
GRAPH 5: THE YIELD CURVE



	3 Mth	6 Mth	1 Year	2 Year	3 Year	5 Year	7 Year	10 Year	30 Year
Apr 25	8.53	8.59	9.22	9.33	9.26	9.16	9.13	9.09	8.95
May 26	8.41	8.39	8.86	8.86	8.82	8.73	8.67	8.63	8.63
June 23	8.13	8.05	8.53	8.5	8.45	8.37	8.38	8.34	8.3

Source: The Federal Reserve Board.

GRAPH 6: FIXED-RATE MORTGAGES CONTINUE TO FALL



*Contract interest rates on commitments for fixed-rate first mortgages.

Source: The Federal Reserve Board.

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

		Total	S-F	2-4	5 and up
May	1989	1331	980	46	285
Apr	1989	1339	1027	64	248
Mar	1989	1409	981	50	378
Feb	1989	1465	1029	62	374
Jan	1989	1678	1199	66	413
May	1988	1392	1001	53	338

May 1989 Changes From:

		Total	S-F	2-4	5 and up
Apr	1989	-2.1%	4.6%	-28.1%	14.9%
May	1988	-5.8%	-2.1%	-13.2%	-15.7%

REGIONAL DATA

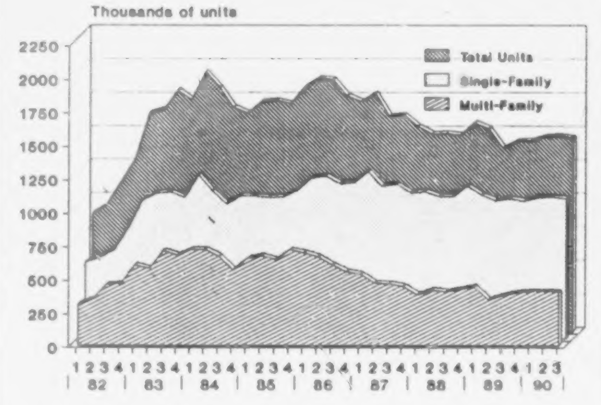
		Northeast	Midwest	South	West
May	1989	186	245	516	364
Apr	1989	206	269	525	339
Mar	1989	160	308	552	389
Feb	1989	224	273	572	396
Jan	1989	293	313	642	430
May	1988	202	267	562	361

May 1989 Changes From:

		Northeast	Midwest	South	West
Apr	1989	-9.7%	-8.9%	-1.7%	7.4%
May	1988	-7.9%	-8.2%	-8.2%	0.8%

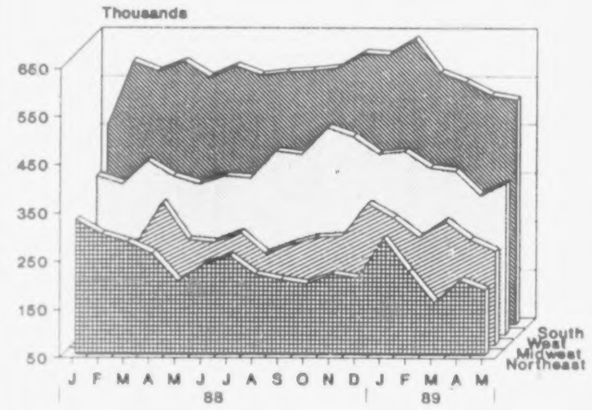
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: The Bureau of Census; E NAR Estimates

GRAPH 8: HOUSING STARTS BY REGION



Source: The Bureau of Census

Housing starts of privately owned homes fell for the fourth consecutive month in May to a seasonally adjusted annual rate of 1.31 million units, the lowest rate in seven years. The decline in starts was brought on primarily by a decline in the construction of single-family homes, which slid 4.6 percent to an annual rate of 980 thousand units, dropping the rate of single-family starts below 1 million units for the second time this year. Starts of structures with 5 or more units staged a comeback in May, climbing 14.9 percent to 285 thousand units, after falling 34.4 percent in April. Given the weakness in housing starts despite some easing in interest rates during May, it appears that builders are waiting for concrete signs of increased homebuying activity and a clearer picture of the economy's direction before they begin to step up construction. While we are not forecasting a surge in housing activity at any time in the near future, we do expect a moderate pickup in housing construction during the summer and early fall, with the second quarter most likely being the low point for housing construction in 1989.

With the exception of the West, every region suffered a set back in construction during May. Starts took their greatest tumble in the Northeast, falling 9.7 percent to a seasonally adjusted annual rate of 186 thousand units. In both the Midwest and the South, starts were down to their lowest rates of 1989, at 245 thousand units and 516 thousand units, respectively. In the West sales rose 7.4 percent to an annual rate of 364 thousand units, and were about even with the 361 thousand unit annual rate of starts in May of 1988.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

May 1989	613	Oct 1988	718
Apr 1989	597	Sep 1988	691
Mar 1989	547	Aug 1988	555
Feb 1989	621	Jul 1988	691
Jan 1989	700	Jun 1988	712
Dec 1988	669	May 1988	701
Nov 1988	650		

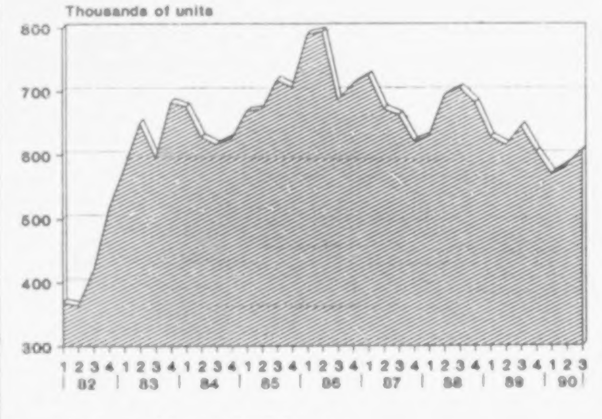
May 1989 Changes From:		Annual Totals:	
Apr 1989	2.7%	1987	671
May 1988	-9.7%	1988	677

REGIONAL DATA

	Northeast	Midwest	South	West
May 1989	98	93	234	197
Apr 1989	87	98	228	183
Mar 1989	110	98	196	143
Feb 1989	84	103	236	198
Jan 1989	121	106	265	207
Dec 1989	109	94	263	204
May 1988	101	93	290	194
1988	102	97	275	202
1987	134	102	288	140
May 1989 Changes From:				
Apr 1989	12.6%	-5.1%	2.6%	7.7%
May 1988	-3.0%	0.0%	-19.3%	1.5%

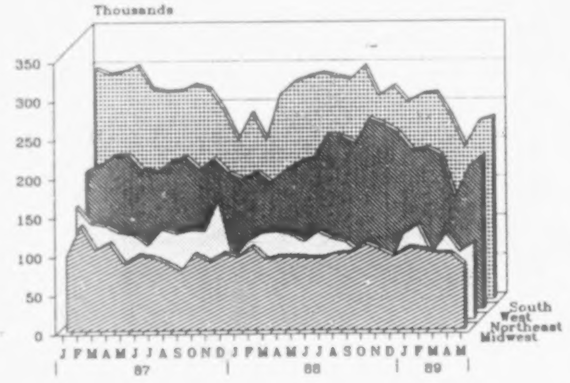
Source: Bureau of the Census, Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: The Bureau of Census; E NAR Estimates

GRAPH 10: NEW HOME SALES BY REGION



Source: The Bureau of Census

After rising 9.1 percent in April, sales of new single-family homes rose an additional 2.7 percent in May to a seasonally adjusted annual rate of 613 thousand units. The two month climb followed a 21.9 percent drop from January, when sales were at an annual rate of 700 thousand units, to March, when sales skidded to 547 thousand units. While most of the sales increase was likely a market adjustment to extraordinarily low rates of sales during February and March, lower interest rates towards the end of May probably drew additional homebuyers into the market. Despite the recent pickup, sales of new homes are still well below the rate of 1988: the May sales rate was 9.7 percent below the 679 thousand unit annual rate of a year ago, and total sales in the opening five months of 1989 are 7.0 percent below the corresponding months of last year (277,000 units compared with 298,000).

The Midwest was the only region to experience a decline in new home sales during May, where sales fell 5.1 percent to a seasonally adjusted annual rate of 93 thousand units. With only few exceptions, sales have been relatively flat in the Midwest for over a year, fluctuating in a narrow range of 93 to 99 thousand units. As for the other three regions, sales have been far more sporadic. Sales were up 12.6 percent in the Northeast, following a 20.9 percent decline in April. In the South sales rose 2.6 percent to a seasonally adjusted annual rate of 234 thousand units. And in the West, sales in May rose 7.7 percent to an annual rate of 197 thousand units.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

May 1989	3210	Oct 1988	3680
Apr 1989	3400	Sep 1988	3640
Mar 1989	3400	Aug 1988	3690
Feb 1989	3480	Jul 1988	3650
Jan 1989	3550	Jun 1988	3800
Dec 1988	3920	May 1988	3620
Nov 1988	3710		

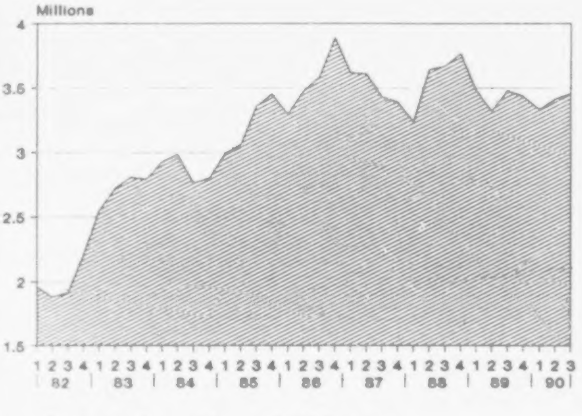
May 1989 Changes From:		Annual Totals:	
Apr 1989	-5.9%	1988	3594
May 1988	-11.3%	1987	3526

REGIONAL DATA

	Northeast	Midwest	South	West
May 1989	590	800	1230	570
Apr 1989	610	890	1280	620
Mar 1989	570	870	1270	670
Feb 1989	600	920	1310	640
Jan 1989	710	930	1310	630
Dec 1988	700	1010	1500	700
Nov 1988	680	940	1410	680
May 1989	690	910	1370	640
1988	673	929	1350	642
1987	685	959	1282	600
May 1989 Changes From:				
Apr 1989	-3.3%	-10.1%	-3.9%	-8.0%
May 1988	-14.5%	-12.1%	-10.2%	-10.9%

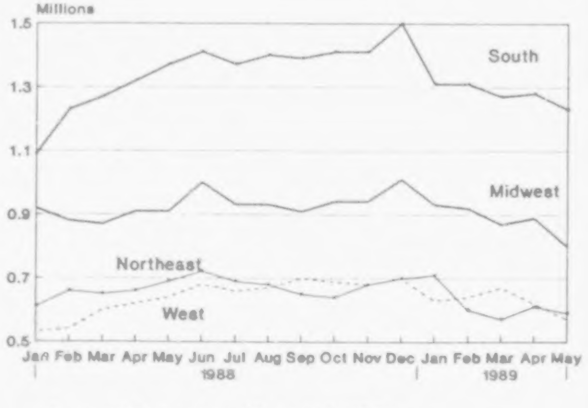
Source: NATIONAL ASSOCIATION OF REALTORS®, Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: The Bureau of Census; E NAR Estimates

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics and Research; E NAR Estimates

Sales of existing single-family homes slid 5.9 percent in May to a seasonally adjusted annual rate of 3.21 million units, putting sales 11.3 percent below the 3.62 million unit annual rate of a year ago. Except for a slight pause in April, the pace of existing home sales has fallen in every month in 1989, with existing home sales now 18.1 percent below their 1989 high of 3.92 million units set in December. Homebuyers have shown considerable reluctance to venture back into the housing market despite falling interest rates. As with builders, many would-be homebuyers are waiting for clear signs of where the economy is headed before purchasing a home. In addition, despite falling interest rates many first-time homebuyers remain locked out of the housing market; often unable to afford the large downpayments necessary as a result of years of steady price increases. The affordability crisis facing many first-time homebuyers is also retarding the ability of many existing homeowners to move up to larger homes.

On a regional basis, existing home sales fell across the board, with the greatest drop occurring in the Midwest. Sales fell 10.1 percent in that region to a seasonally adjusted annual rate of 800 thousand units. In the West, sales fell for the third consecutive month, dropping 8.0 percent to an annual rate of 570 thousand units. In the South, sales were down by 3.9 percent in May at an annual rate of 1.23 million units, the lowest rate in more than seven years. The Northeast experienced the most moderate monthly decline of 3.3 percent. However, at an annual rate of 590 thousand units, sales are now 14.5 percent below the Northeast's annual rate of a year ago.

SINGLE-FAMILY HOME PRICES

	Median		Average	
	Existing	New	Existing	New
May 1989	$93,100	$125,000	$117,600	$158,800
Apr 1989	92,900	116,000	118,000	145,900
Mar 1989	92,000	124,000	116,100	148,400
Feb 1989	91,900	118,000	117,800	145,300
Jan 1989	89,700	113,000	113,000	138,600
May 1988	$89,600	$110,000	$113,300	$133,500
1988	89,300	112,500	112,800	138,200
1987	85,600	104,500	106,300	127,200
May 1989 Changes From:				
Apr 1989	0.2%	7.7%	-0.3%	8.8%
May 1988	3.9%	13.6%	3.8%	19.0%

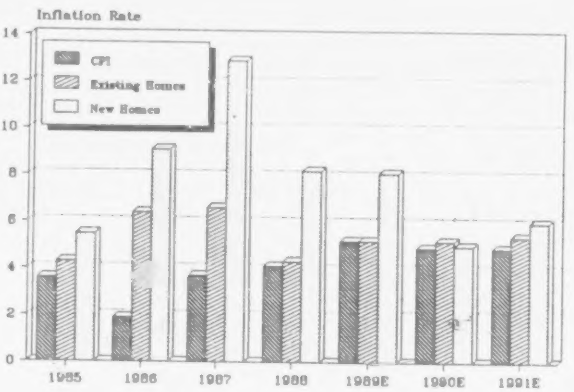
REGIONAL DATA

MEDIAN SALES PRICE OF AN EXISTING HOME

	Northeast	Midwest	South	West
May 1989	$147,500	$69,600	$85,600	$136,300
Apr 1989	144,000	70,400	85,200	142,700
Mar 1989	143,600	69,900	84,000	138,000
Feb 1989	142,600	69,900	86,700	127,800
Jan 1989	143,800	67,800	82,400	130,700
May 1988	$144,100	$69,000	$84,200	$123,100
1988	143,000	68,400	82,200	124,900
1987	133,300	66,000	80,400	113,200
May 1989 Changes From:				
Apr 1989	2.4%	-1.1%	0.5%	-4.5%
May 1988	2.3%	0.8%	1.6%	10.7%

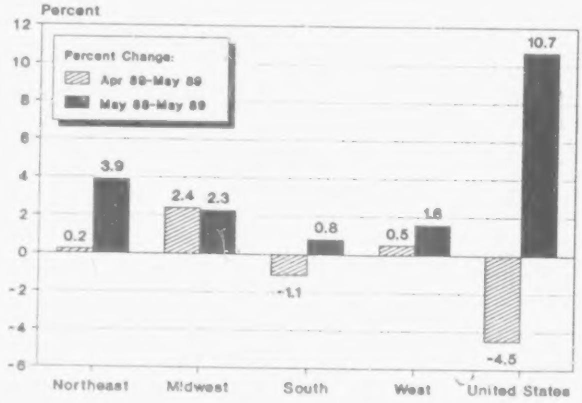
Source: NATIONAL ASSOCIATION OF REALTORS®, Economics and Research Division

GRAPH 13: HOME PRICES



Source: The Bureau of Census; E NAR Estimates

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics and Research; E NAR Estimates

The median sales price of an existing single-family home inched up 0.2 percent in May to $93,100, marking a modest 3.9 percent increase over the $89,600 median price of a year ago. Meanwhile, the median price of a new single-family home jumped 7.7 percent over the April median price, and 13.6 percent above that of a year ago, to $125,000 in May, following a 6.5 percent decline during April. The decline in the median price of a new home during April was due in part to a shift in sales activity from higher priced regions to generally lower priced areas. Exactly the opposite was true for the steep increase in new home prices during May. New home sales in the higher priced markets of the Northeast and West were up considerably when compared with those in the lower priced regions of the South and Midwest, thus boosting the national median price of new homes.

Regionally, the median price of an existing single-family home was up 2.4 percent in the Northeast, and 0.5 percent in the South, at $147,500 and $85,600, respectively. In the West, the median price declined 4.5 percent to $136,300, while the price in the Midwest dropped 1.1 percent to $69,600. Regional price appreciation for the twelve months ending in May was modest, with only the West experiencing any substantial gain, rising 10.7 percent. In the other three regions, the median price of an existing home appreciated by 2.3 percent in the Northeast, 0.8 percent in the Midwest, and 1.6 percent in the South.

Sean A. Burns, Director of Forecasting
Beth M. Maerz, Research Associate

INFLATIONARY DISTORTIONS AND REAL ESTATE TAX PROVISIONS

Recent Rumors concerning possible changes in the capital gains tax and expectations about rising prices have revived the issue of indexation of taxes for inflation. It has been reported that Representative Dan Rostenkowski (D. Ill.), Chairman of the House Ways and Means Committee, is considering, among other things, the indexation of the capital gains base to account for inflation.[1] The existence of inflation, it is argued, creates a problem for the equitable taxation of income because it causes fictitious income to be taxed. Although there is widespread acknowledgement that the taxation of income from capital imposes taxes on income that do not reflect increases in real purchasing power, there is still some confusion as to why income from capital should be treated differently from income from labor.[2] [3] This paper examines the distortions caused by the interaction of inflation and real estate tax provisions and attempts to clarify the distinction between income from capital and income from labor.

Specifically, inflation has distortionary effects on at least three real estate tax provisions. First, capital gains taxes are affected because real estate capital gains include inflationary gains. Second, during inflationary periods, depreciation allowances based on historical costs are generally not adequate to allow for the tax-free recovery of investments. Finally, the mortgage interest payments allowed to be taken as a deduction includes an inflationary component. This paper is the first of a three part series which investigates the consequences of inflation for each of these real estate tax provisions. This part deals with the interaction of the capital gains tax and inflation.

CAPITAL GAINS TAX

Inflation introduces a bias in the taxation of capital gains because part of the gain does not represent any increase in real purchasing power. Take, for example, an asset purchased for $100. If the inflation rate is 10 percent and the asset rises in value by the inflation rate, then the asset will have a market value of $110 at year end, the $10 of nominal capital gain being taxable. However, because inflation has increased the general price level by 10 percent, the $110 received upon sale cannot purchase any more goods and services than could the $100 the asset was purchased for. Thus, the $10 of capital gains which is subject to taxation is purely fictitious income reflecting no real gain in purchasing power.

Why should capital gains be treated any differently than is wage income? After all, wages are subject to inflationary pressures as well. Table 1 illustrates this difference with a simple example. Suppose a household receives $30,000 in income. In the absence of inflation, assuming a flat tax of 20 percent, the household would pay a tax of $6,000. Now consider the case where inflation increases all prices and incomes by 5 percent. Wage income rises to $31,500 and the tax due is now $6,300. Although the household pays a greater nominal value in taxes it also receives a higher nominal wage income so that it is no better or worse off than before. Its after tax income of $25,200 is capable of purchasing the same amount of goods and services as the $24,000 it would have received in the absence of inflation.[4] Similarly, the $6,300 the government receives in the form of taxes can purchase an equivalent amount of goods and services as the $6,000 it would have received in the absence of inflation. Thus, both the household and government are no better or worse off due to inflation.

Unfortunately, the capital gains tax is not neutral with respect to the income tax, as Table 1 indicates. Suppose a household holds an asset which it purchased for $10,000 and which appreciates at a real rate of 10 percent per year. If the household sells the asset after holding it for a year[5], it would receive $11,000 and pay a tax of $200 on the capital gain of $1,000. Thus, the household would end up with $10,800 after taxes from the sale of the asset. Now, suppose that inflation increases all prices by 5 percent. The asset would now yield $11,550 upon sale in a year.[6] The household would pay a tax of $310 on $1,550 of capital gains. The household is now worse off because it receives only $11,240 after tax from the sale of its asset. Although this is more than the after tax price of $10,800 the household would have received in the absence of the tax, it is equivalent to only $10,705 in real purchasing power. Thus, the household has lost some purchasing power due to the interaction of inflation and the capital gains tax. What happens to government revenue? The tax paid on the capital gain is equivalent to $295 in real revenue. Thus, government has gained from the distortionary effects of inflation.

Inflation Neutral Capital Gains Tax

How can the capital gains tax provision be made neutral in the presence of inflation? Economists have long advocated use of indexation to correct for inflationary biases. The indexation plan would work as follows. The capital gains base (the purchase price of $10,000) would be indexed for inflation (multiplied by 1.05 - the inflation index) to reflect current market prices. The indexed base of $10,500 reflects the current market price of the asset before real appreciation. This base is subtracted from the actual sales price of the asset of $11,550. The resulting value of $1,050 is used to derive the tax on capital gains of $210. Households would receive an amount of $11,340 after taxes from the sale of the asset, which is equivalent to $10,800 in real value. The government would receive $210 in taxes which is equivalent to $200 in real value. Thus, indexation leaves the household in the same financial situation as in the no-inflation case!

Table 1
Income, Inflation, and Taxes

Wage Income	Zero Inflation	Five Percent Inflation
(1) Wages	30,000	31,500
(2) Tax @ 20%	6,000	6,300
(3) After Tax Income	24,000	25,200
(4) Real Value of Tax	6,000	6,000
(5) Real Value of After Tax Income	24,000	24,000

Capital Gains Asset Appreciates at 10% Real Rate	Zero Inflation	Five Percent Inflation	Five Percent Inflation With Indexation
(1) Selling Price	11,000	11,550	11,550
(2) Purchase Price	10,000	10,000	10,000
(3) Indexed Captial Gains Base	NA	NA	10,500
(4) Taxable Capital	1,000	1,550	1,050
(5) Tax on Cap. Gain @20%	200	310	210
(6) After Tax Price	10,800	11,240	11,340
(7) Real Value of Tax	200	295	200
(8) Real After Tax Asset Value	10,800	10,705	10,800

Other Aspects of the Capital Gains Tax

The previous analysis ignored the current tax advantages arising from the taxation of capital gains on realization rather than accrual. Since the tax payment can be deferred until the asset is sold, the deferral is like an interest-free loan on the tax payment. This feature of the current tax code alleviates some of the distortions caused by inflation. Table 2 illustrates this point. The fourth column displays the tax that would be due for different holding periods on an asset purchased for $10,000 appreciating at a real rate of 4 percent in an environment where inflation is increasing prices at 5 percent annually. The combination of inflation and deferral has offsetting effects for the capital gains tax. Moreover, the distortions caused by inflation declines as the holding period increases because a greater amount of tax payment is being deferred. The fourth column in Table 2 calculates the tax that would be due if there were inflation indexation and no deferral. A comparison of the tax liabilities under the current system and the "ideal" system shows that as the holding period increases, the tax advantage due to deferral tends to offsets the additional tax due to inflation. For example, if the asset is held for 15 years, the tax liability under the current system would be $7,683 while the tax liability under the "ideal" system would be approximately the same at $7,698. If the asset were held for a longer period of time, the current system would produce a lower tax liability than the "ideal" system.

The current tax system which allows the capital gains tax to be deferred has both pros and cons. An advantage to taxation upon realization rather than accrual is that it does not impose liquidity problems on the asset holding taxpayer. Another advantage is that the valuation of asset value is not a problem if the capital gains is taxed at realization. If the tax were imposed upon accrual, the asset would have to be valued annually. Although this would not be a problem for stocks, it may be a costly and inaccurate process for physical assets such as real estate. A disadvantage of deferral is that it provides an incentive for taxpayers to postpone realizations since it is like borrowing money at no cost from the government.

Recent proposals that have been raised with respect to the capital gains tax such as the tax rate preference and inflation indexation do not include any discussions on the issue of deferral. Thus, it is possible that deferral is a deliberate policy taken by the government because of the advantages of taxing capital gains upon realization. The last two columns of Table 2 displays the tax liabilities for various holding periods under a maximum preferred capital gains rate of 15 percent and under inflation indexation at the maximum ordinary rate. A comparison of these two methods to the "ideal" method (in column 5) illustrates that longer held assets fare better than shorter held assets. An additional observation that can be made from the comparison of the two proposals is that the proposal for a capital gains tax cut becomes more attractive relative to the proposal to index the basis for inflation if the asset is held longer.

CONCLUSION

The presence of inflation biases the capital gains tax in favor of government and against taxpayers. Inflation results in higher real and nominal capital gains tax revenue being collected by the government, while reducing the real after tax proceeds from the sale of the asset going to the taxpayer. This distortion is larger for higher inflation rates and affects assets held for a shorter period of time more significantly due to the nature of the current capital gains tax provision.

by
T. Emi Miyake
Director of Tax Research
Forecasting and Policy Analysis Division

1.E.g., Washington Post, June 14, 1989.

2.We shall abstract from the notion of income from "Human capital" to keep the analysis simple.

3.There is some disagreement concerning the justification for differential treatment of capital gains. Some economists argue that all flows of income should be treated the same. They argue that the comparison of the effects of taxation and inflation on the stock of capital to the effects on the flow of income is not relevant.

4. The real value of income is calculated by deflating the nominal value by the inflation factor, that is $25,200/1.05 = $24,000.

5.We postpone the consequences of the ability to defer the capital gains tax to concentrate on the effect of inflation alone. Keeping the holding period to a period of one year and the use of non-compounding inflation and appreciation rates allow us to avoid discussion of the deferral provision.

6.Calculated as $10,000(1+.10)(1+.05) = $11,550, where the real appreciation rate is 10 percent and the inflation rate is 5 percent.

Table 2
Alternative Taxes on Capital Gains

Assumptions:

Inflation = 5.00%
Real Appreciation = 4.00%
Nominal Appreciation = 9.20%

			Theoretical Ideal:	Current Law:	Bush Proposal:	Indexation For Inflation:
Holding Period	Nominal Price	Realize Gain	Current Value of Tax with Indexation and no Deferral	Tax on Realized Gain @28%	Tax on Nominal Realized Gain @15%	Tax on Realized Gain with Deferral and Indexation @28%
0	10,000					
1	10,920	920	118	258	138	118
2	11,925	1,925	263	539	289	252
3	13,022	3,022	440	846	453	405
4	14,220	4,220	654	1,182	633	578
5	15,528	5,528	910	1,548	829	774
6	16,956	6,956	1,215	1,948	1,043	996
7	18,516	8,516	1,576	2,385	1,277	1,245
8	20,220	10,220	2,001	2,862	1,533	1,525
9	22,080	12,080	2,499	3,382	1,812	1,839
10	24,112	14,112	3,080	3,951	2,117	2,190
11	26,330	16,330	3,757	4,572	2,449	2,583
12	28,752	18,752	4,541	5,251	2,813	3,022
13	31,397	21,397	5,448	5,991	3,210	3,511
14	34,286	24,286	6,494	6,800	3,643	4,056
15	37,440	27,440	7,698	7,683	4,116	4,662

U.S. ECONOMIC OUTLOOK

JULY 1989

	QUARTERS										YEARS		
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	88.4	89.1	89.2	89.3	89.4	90.1	90.2	90.3	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5000	5099	5188	5257	5336	5424	5499	5578	4527	4864	5220	5541	5908
% Change	7.6	8.2	7.2	5.4	6.2	6.8	5.7	5.9	6.8	7.5	7.3	6.1	6.6
% Change (w/out inflation)	2.4	4.4	2.0	1.3	1.8	1.9	1.5	1.7	3.4	3.9	2.7	1.7	2.3
Consumer Price Inflation (CPI)	4.4	5.4	6.7	4.2	4.8	5.0	4.8	4.8	3.7	4.1	5.2	4.9	4.9
GNP Inflation (GNP Deflator)	5.3	3.6	4.9	4.0	4.2	4.7	4.1	4.1	3.3	3.4	4.5	4.3	4.2
Unemployment Rate - Civilian	5.3	5.2	5.2	5.2	5.4	5.4	5.5	5.6	6.2	5.5	5.2	5.5	5.4
Civilian Employment-Household Basis (millions)	115.8	116.9	117.2	117.6	117.9	118.1	118.4	118.7	112.4	115.0	117.4	118.5	120.1
Percent change	2.2	3.7	1.1	1.3	0.9	0.9	0.9	0.8	2.6	2.3	2.1	1.0	1.3
Index of Industrial Production	139.9	140.6	141.6	142.0	143.1	143.9	144.6	145.2	129.8	137.2	141.8	144.8	148.1
Manufacturing Capacity Utilization	84.4	84.3	84.1	83.5	83.6	83.6	83.4	83.2	81.0	83.6	83.9	83.3	83.0
Domestic Auto Sales	7.5	6.9	7.2	7.1	7.0	7.0	7.0	7.0	7.1	7.5	7.1	7.0	7.1
Federal Tax Receipts (NIPA) as % of GNP	19.8	20.4	20.5	20.3	20.4	20.7	20.7	20.8	20.2	20.1	20.4	20.8	20.9
Federal Expenditures (NIPA) as % of GNP	23.0	23.2	22.9	22.8	22.7	22.8	22.8	22.7	23.7	23.0	22.9	22.7	22.5
Deficit(NIPA)	-157.5	-139.5	-121.7	-129.4	-124.3	-113.5	-111.4	-108.9	-157.8	-142.4	-128.7	-110.0	-99.2
as % of GNP	-3.2	-2.7	-2.3	-2.5	-2.3	-2.1	-2.0	-2.0	-3.5	-2.9	-2.5	-2.0	-1.7
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4877	4515	4319	4493	4431	4355	4439	4469	4648	4651	4439	4427	4487
Percent change – year ago	9.7	-2.0	-7.5	-4.2	-9.1	-3.5	2.8	-0.5	-1.4	0.1	-4.5	-0.3	1.3
Existing Single-family Home Sales (thousands)	3773	3477	3320	3480	3435	3335	3415	3455	3526	3594	3428	3405	3455
Percent change – year ago	11.3	5.4	-8.9	-5.0	-9.0	-4.1	2.9	-0.7	-1.1	1.9	-4.6	-0.7	1.5
Housing Starts (thousands)	1559	1517	1370	1423	1425	1458	1462	1447	1634	1496	1434	1458	1450
Percent change – year ago	1.7	2.8	-7.4	-3.0	-8.6	-3.9	6.7	1.7	-9.8	-8.5	-4.1	1.7	-0.6
Single-Family Units	1138	1070	1030	1045	1027	1052	1056	1045	1157	1089	1043	1054	1064
Percent change – year ago	4.5	-2.5	-3.0	-1.5	-9.8	-1.7	2.5	0.0	-2.2	-5.8	-4.3	1.1	0.9
Multi-Family Units	420	448	341	378	398	406	406	402	477	406	391	404	386
2-4 Family Units	65	59	45	50	53	54	54	53	66	59	52	54	51
Percent change – year ago	16.0	5.3	-21.3	-12.1	-19.3	-9.3	19.3	6.2	-22.6	-10.3	-12.2	3.4	-4.5
5 + Family Units	355	388	295	328	345	352	353	349	412	347	339	351	335
Percent change – year ago	-8.2	20.0	-18.2	-6.0	-2.8	-9.3	19.3	6.2	-24.4	-15.7	-2.3	3.4	-4.5
New Single-family Home Sales (thousands)	679	623	615	645	605	570	585	607	671	677	622	587	644
Percent change – year ago	9.3	-1.1	-11.8	-8.3	-10.9	-8.5	-4.9	-5.9	-10.5	0.9	-8.1	-5.6	9.7
Mobile Homes Shipped (thousands)	223	217	221	200	199	206	210	211	233	217	209	211	237
HOME PRICES													
Existing Home Prices - Median $(1000)	88.7	91.2	93.3	95.2	96.0	96.6	98.0	99.3	85.6	89.3	93.9	98.8	104.1
Percent change – year ago	4.4	3.9	4.9	5.5	8.2	5.9	5.0	4.3	6.6	4.3	5.2	5.2	5.4
New Home Prices - Median $(1000)	114.9	118.3	121.4	123.1	123.5	124.7	126.9	128.4	104.0	112.5	121.6	127.7	135.4
Percent change – year ago	2.8	4.8	7.5	7.1	7.5	5.4	4.5	4.3	13.0	8.2	8.1	5.0	6.0
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.6	10.9	10.2	9.9	10.1	10.3	10.3	10.5	10.2	10.5	10.3	10.1	10.1
1-year ARM (without buydown)	8.5	8.8	9.0	8.7	8.5	8.5	8.4	8.4	8.5	8.5	8.8	8.4	8.5
Corporate AAA Bond Rate	9.5	9.7	9.5	9.0	8.8	8.7	8.7	8.7	9.4	9.7	9.3	8.7	9.1
Government Bond Rate	9.0	9.0	8.7	8.3	8.8	9.0	8.8	8.6	8.6	9.0	8.7	8.7	8.3
Short-Term Interest Rates													
Federal Funds Rate	8.5	9.4	9.7	9.1	8.7	8.7	8.4	8.2	6.7	7.6	9.2	8.4	8.9
3-month T-Bill Rate	7.7	8.5	8.4	8.2	7.7	7.6	7.3	7.2	5.8	6.7	8.2	7.3	7.7
Prime Rate	10.2	11.0	11.4	11.0	10.5	10.4	10.0	9.9	8.2	9.3	11.0	10.1	10.7
Discount Rate	6.5	6.7	7.0	7.0	6.8	6.6	6.4	6.2	5.7	6.2	6.9	6.3	6.5
Value of the U.S. Dollar (Trade-Weighted Avg.)	93.0	96.0	100.4	100.0	98.0	95.5	93.9	92.0	96.9	92.8	99.3	92.7	86.8
Percent change	-17.6	13.5	19.7	-1.4	-7.9	-9.9	-6.2	-7.9	-13.6	-4.3	7.0	-6.6	-6.3

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz.

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

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Vol. 2, No. 8

August 1989

REAL ESTATE OUTLOOK

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- According to the U.S. Department of Commerce, economic growth slowed in the second quarter, as the annual rate of growth of real Gross National Product expanded by a modest 1.7 percent. The slower pace, which marked the lowest rate since the third quarter of 1986, seems to be in line with the "soft landing" that the Federal Reserve has been aiming for.
- After months of steep increases, the consumer price index posted a modest 0.2 percent gain in June, while the producer price index actually declined 0.1 percent in the same period.
- The Federal Reserve allowed the federal funds rate to drop fifty basis points to 9.0 percent in July. Financial institutions quickly followed suit and lowered the prime rate to 10.5 percent from 11.0 percent.
- Starts of privately owned homes jumped 7.0 percent in June to a seasonally adjusted annual rate of 1.4 million units. The increase (the first in five months) was not spurred by the long-awaited rebound of the single-family market, but rather by a 28.0 percent jump in the construction of multi-family units.
- Sales of new single-family homes continued to rise in June, climbing 5.5 percent to a seasonally adjusted annual rate of 670 thousand units. Sales have risen 20.9 percent over the past three months, from their 1989 low of a 555 thousand unit annual rate set in March.
- Encouraged by lower mortgage rates, sales of existing single-family homes moved forward for the first time in 1989, rising 5.9 percent in June to an annual rate of 3.4 million units.
- Despite the surge in existing home sales, prices increased only modestly in June, creeping up 0.6 percent to a median price of $93,200. The median price of a new home jumped 8.2 percent to $129,900, or 16.5 percent above the median price of a year ago.

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REALTOR®

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The Birds and the Bees - But Mostly the Bees

by
John A. Tuccillo
Chief Economist and
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Why are we so fascinated with bees? From Aristophanes to *Saturday Night Live*, bees have been a recurring theme. One of my sharpest memories of early television is the Wheat Honeys commercial on the old Wild Bill Hickcock show, mainly because they featured an animated character called Buffalo Bee. For years, our attention has been periodically diverted by the northward migration of "killer" bees. And, of course, bees along with other mutant forms of insects have been the villains (or heroes) of sci-fi movies. In effect, their social organization - the clustering together in hives with work responsibilities clearly delineated - makes bees, like ants, simultaneously an ideal for the human community and a monolithic terror from which we are saved only because of size differences.

Now technology has brought the beehive ideal a little closer to reality. The major upshot of the technological revolution through which we are living is an information explosion. We know more things more accurately about more people than could have ever, in the past, been imagined, much less accomplished. So we create human equivalents of bee hives and describe households by a list of characteristics that outline the particular cell of the hive that they inhabit. Marketing of consumer products now relies heavily on cluster analysis, which, like "rednecks," "urban pioneers," and "suburban sophisticates," can be based on whether they drive Broncos or Volvos or Camrys, eat Cheet-Os or Brie or tuna steaks, listen to George Strait or Yitzhak Perelman or Carly Simon, and watch "Roseanne," "Thirty Something" or "The Cosby Show." Using these breakdowns the test marketing of a given product can be carefully targeted to certain zip codes that contain the right cluster.

Of course, all this is both more complicated and less precise than applied above. But the fact remains that this information Veg-O-Matic has sliced, diced and chopped the American public and imposed, at least conceptually, a beehive on our society.

The implications of these developments extend beyond marketing of consumer products. Two major types of consumer information businesses are finance and real estate. As we absorb the baby boom and the baby bust, the ability to view the market through the metaphor of the beehive can be quite useful not only in each of these areas, but also in their overlap. Three comments are in order:

1. Niche marketing will become much more important. Especially in real estate, but also in financial services, small firms can survive and prosper by being the very best in a limited market. But without the ability to describe and predict certain carefully defined categories of the population, there is the real potential of specializing in an empty market. As an absurd example, specializing in ten-plus bedroom single-family homes for low income families does not seem to be a growth industry.

2. Customers are more sophisticated. Financial institutions can no longer claim the highest yields if that is not the case. Information about interest rates is simply too available. But conversely, knowing more about household groupings enables the specific design of financial products, ranging from the Knights of Columbus VISA credit card to a certificate of deposit whose return is predicated on the number of goals scored by the local box lacrosse team. The bottom line here is that successful competition requires that increasingly sophisticated customers be matched with an increasingly sophisticated appeal.

3. Service will be a key business attribute. Technology allows clustering, and at the same time cuts the cost of direct marketing. Most of the readers of this piece are accustomed to absorbing information off the printed page. Within five years, that majority will be composed of individuals who receive information most easily electronically. Being proficient at offering very well-defined products and services through visual imagery will become the best way to serve this market. But in a world where technique dominates, anyone can sell any product, and the lines between the selling of real estate and its financing begin to blur.

Any analogy breaks down if pushed too far, so it's time to stop. We are in fact deeply into a rapidly evolving information age that will create markets that are as tightly defined and intricately linked as the cells in a beehive. And those who can't accommodate those markets may be unpleasantly stung.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

According to the U.S. Department of Commerce, economic growth slowed in the second quarter, as the annual rate of growth of real Gross National Product expanded by a modest 1.7 percent. The slower pace, which marked the lowest rate since the third quarter of 1986, appears to be right in line with the "soft landing" that many economists have forecasted, and the Fed has hoped for. Despite the rather high rate of inflation (5.2 percent as measured by the GNP price index in the second quarter), the slowdown is likely to convince the Fed that its credit tightening efforts have gone far enough, which could mean lower short-term interest rates in the second half of this year. But few economic reports go unchallenged and this GNP release was no exception: for some, it has heightened concerns that a recession could be waiting in the wings.

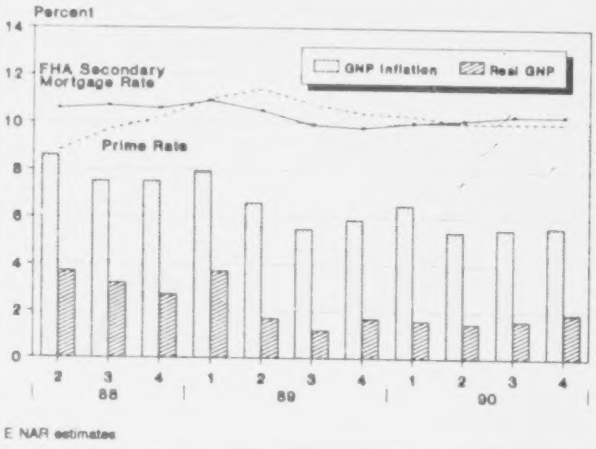
Each July, Government economists revise the nation's economic ledger by releasing three years worth of revised estimates for the National Income and Product Accounts. Overall, the economy has been growing at a faster rate than previously estimated: an average annual rate of 3.6 percent rather than the previous estimate of 3.3 percent during the 1986-88 period; and 4.4 percent in 1988 alone -- the fastest annual rate of expansion since 1984.

For the most part, the composition of second quarter non-farm growth did not differ much from that of the first quarter. Personal consumption expenditures continued to moderate, marking their weakest advance since the fourth quarter of 1987. However, unlike the previous quarter, spending on durable goods picked up, (this category includes furniture, household equipment, and automobiles) while consumers shied away from nondurable food and energy products. Despite declining interest rates, cautious builders and developers awaited signs of stronger market activity, leading to a two-quarter consecutive decline in investment in both residential and nonresidential structures. Investment continued on producers' durable equipment, showing manufacturers are still making efforts to expand capacity, recently strained by six and a half years of expansion. Finally, the U.S. trade sector was unable to carry the momentum of the first quarter into the second, as a stronger dollar encouraged imports while dampening exports somewhat. As a result, net exports added $2.4 billion to real GNP growth in the second quarter, substantially less than the $18.8 billion added by net exports in the first quarter.

Manufacturers Keep Tight Reign on Inventories

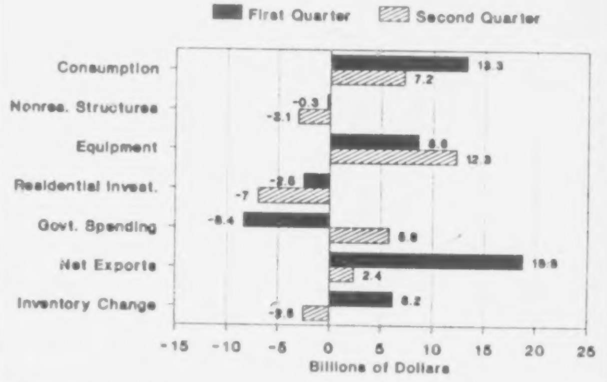
Inventory investment, which subtracted $2.5 billion from real GNP growth in the second quarter, has held a steady course of restraint over the past year. Large inventories late in an expansion can often contribute to a recession as businesses cut back production in order to sell off their excess stocks in the face of slow demand. Aside from technological advances in communications and transportation, which are generally credited for the recent progress in inventory management, the absence of substantial price increases may have discouraged the stockpiling witnessed during past business cycles. The current low manufacturing inventory-to-sales ratio is cited as an indication that businesses have managed their inventories well in the current expansion. Prior to the 1981-82 recession, the ratio fluctuated around 1.9 percent. Throughout 1989, it has remained below 1.6 percent.

GRAPH 1: THE ECONOMIC OUTLOOK



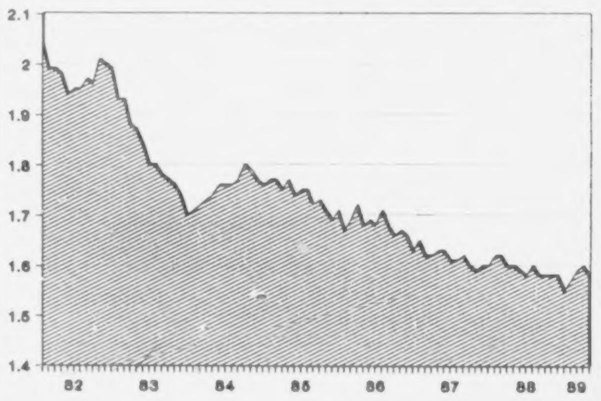
E NAR estimates

GRAPH 2: THE COMPOSITION OF GNP GROWTH



Source: Department of Commerce.

GRAPH 3: INVENTORY-TO-SALES RATIO REMAINS UNDER CONTROL AT THE NATIONS' FACTORIES



Source: The Bureau of Economic Analysis.

Monthly Indicators Signal Slower Growth

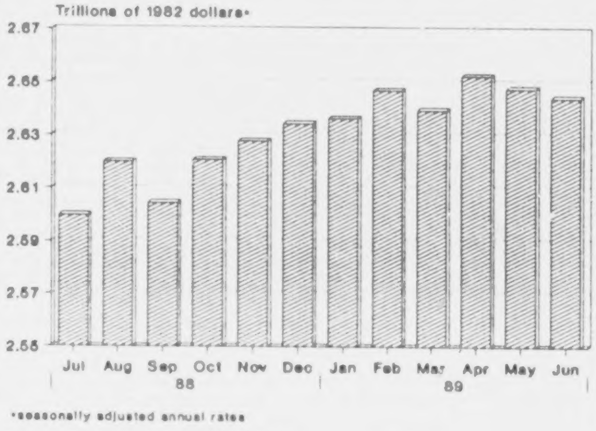
A variety of monthly economic indicators continued to forecast slower economic growth. The closely watched Purchasing Managers index fell for the third consecutive month in June to 46 percent. Historically, a dip in the index to levels near 44 percent are generally associated with a recession (reports higher than 50 percent usually indicate an economic expansion). Other recent indications of a slowing economy included a 0.4 percent decline in retail sales, a 0.2 percent drop in industrial production, a 0.8 percent drop in construction spending, and a 0.1 percent fall in the index of leading indicators. Graph 5 shows the course of real personal consumption expenditures over the past year. For the past two months, consumer spending has been virtually at a standstill, leading to a decline in real, or inflation-adjusted, expenditures. Consumers have scaled back their purchases of durable goods for the second month in a row, while moderating their spending on nondurables and services. Moreover, in terms of 1982 dollars, only nondurable expenditures registered a gain in June. With consumption making up almost two-thirds of total GNP, slower spending will likely continue to retard economic growth. There is an encouraging footnote to slower consumer spending: the personal savings rate, falling dramatically during the early years of this consumption-led expansion, has risen by almost one and a half percentage points during the first six months of 1989, reaching 5.9 percent in June.

One of the first monthly indicators on the state of third quarter economic growth is the July employment report, released just as this newsletter went to print. The Labor Department estimates that private non-agricultural employment increased by 195 thousand jobs in July, pulling the unemployment rate down to 5.2 percent from 5.3 percent. Most of the employment increase originated from service sector gains. While manufacturing sector employment growth was flat in July, other portions of the employment report suggested the economy is still growing moderately. Specifically, both the average workweek and the index of aggregate weekly hours increased, as did average hourly earnings.

MONETARY POLICY AND INTEREST RATES

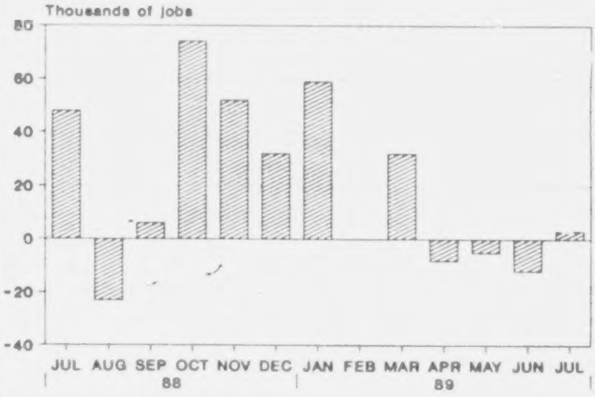
After months of steep increases, the consumer price index posted a modest 0.2 percent gain in June, while the producer price index actually declined 0.1 percent in the same period. The encouraging news took the spotlight off inflation and instead focused attention on the sagging economy. In response, the Fed has allowed the federal funds rate to drop fifty basis points to 9.0 percent. Financial institutions quickly followed suit and lowered the prime rate to 10.5 percent from 11.0 percent. We expect that the Fed will continue to ease during the late summer and early fall. However, in the absence of any substantial retreat of inflation, financial markets will most likely keep long-term rates from falling much below their current levels, as inflation expectations remain within the range of 4 to 5 percent. In fact, we expect to see a slight increase at the long end of the yield curve towards the end of the year, leading to a more "normal" shaped yield curve than we have seen in recent months. As a result, mortgage rates will probably bottom out just above 9 percent before possibly rising modestly in late 1989.

GRAPH 4: REAL PERSONAL SPENDING SLOWS



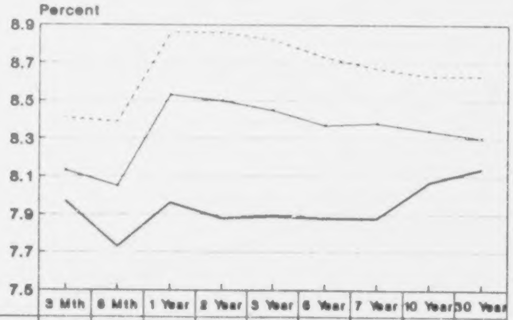
Source: The Bureau of Economic Analysis

GRAPH 5: MANUFACTURERS CUT PAYROLLS IN THE SECOND QUARTER



Source: Bureau of Labor Statistics

GRAPH 6: THE YIELD CURVE



	3 Mth	6 Mth	1 Year	2 Year	5 Year	5 Year	7 Year	10 Year	30 Year
May 26 ----	8.41	8.39	8.86	8.86	8.82	8.73	8.67	8.63	8.63
Jun 23 ——	8.13	8.05	8.53	8.5	8.45	8.37	8.36	8.34	8.3
Jul 29 ——	7.97	7.73	7.96	7.88	7.89	7.88	7.88	8.07	8.14

Source: The Federal Reserve Board.

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

		Total	S-F	2-4	5 and up
Jun	1989	1400	975	53	372
May	1989	1309	977	40	292
Apr	1989	1343	1029	62	252
Mar	1989	1409	981	50	378
Feb	1989	1465	1029	62	374
Jun	1988	1463	1088	62	313

Jun 1989 Changes From:

May	1989	7.0%	-0.2%	32.5%	27.4%
Jun	1988	-4.3%	-10.4%	-14.5%	18.9%

REGIONAL DATA

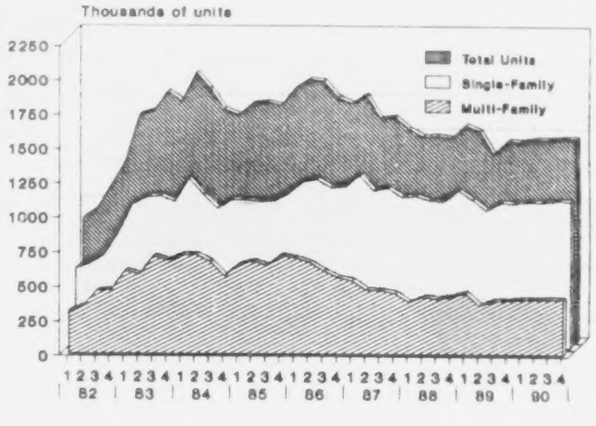
		Northeast	Midwest	South	West
Jun	1989	171	238	548	443
May	1989	180	246	518	365
Apr	1989	207	274	526	336
Mar	1989	160	308	552	389
Feb	1989	224	273	572	396
Jun	1988	238	262	585	378

Jun 1989 Changes From:

May	1989	-5.0%	-3.3%	5.8%	21.4%
Jun	1988	-28.2%	-9.5%	-6.3%	17.2%

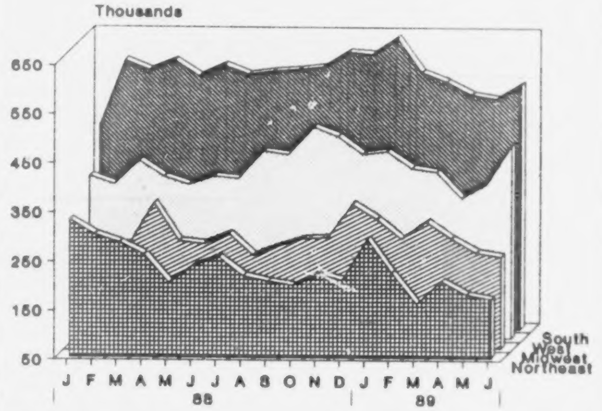
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source The Bureau of Census; E NAR Estimates

GRAPH 8: HOUSING STARTS BY REGION



Source: The Bureau of Census

Starts of privately owned homes jumped 7.0 percent in June to a seasonally adjusted annual rate of 1.4 million units. The increase (the first in five months) was not spurred by the long-awaited rebound of the single-family market, but rather by a 28.0 percent jump in the construction of multi-family units. Starts of single-family homes, which have fallen by more than 18 percent since January, are generally far more dependent on interest rates and economic conditions than the construction of multi-family units and thus offer a better gauge of the residential construction industry's health. The reluctance on the part of builders to step up the rate of single-family starts despite falling interest rates is an indication that the housing industry remains concerned and uncertain over the future health of the economy. However, given the recent uptick in sales of both new and existing single-family homes during June, we expect to see a moderate increase in the rate of starts in the coming months.

The only region to retain a strong rate of housing starts in 1989 has been the West, where starts rose 21.4 percent in June to 443 thousand units, 17.2 percent faster than a year ago. While starts were up in the South by 5.8 percent during June, they were 6.3 percent below the rate of starts in June of 1988. Starts in the Northeast and Midwest have fallen for four of the past five months, leaving starts 41.6 percent below their January 1989 rate in the Northeast, and leading to a cumulative five month decline of 24.0 percent in the Midwest.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Jun 1989	670	Nov 1988	650
May 1989	635	Oct 1988	718
Apr 1989	609	Sep 1988	691
Mar 1989	555	Aug 1988	712
Feb 1989	621	Jul 1988	701
Jan 1989	700	Jun 1988	716
Dec 1988	669		

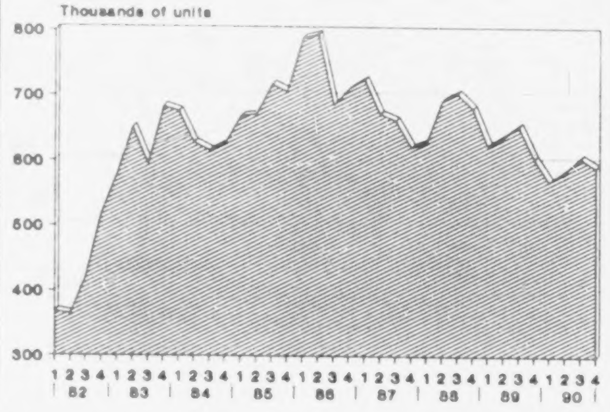
June 1989 Changes From:		Annual Totals:	
May 1989	5.5%	1987	671
Jun 1988	-6.4%	1988	676

REGIONAL DATA

	Northeast	Midwest	South	West
Jun 1989	72	99	267	232
May 1989	88	96	262	188
Apr 1989	82	101	244	183
Mar 1989	107	99	201	148
Feb 1989	84	103	236	198
Jan 1989	121	106	265	207
Jun 1988	114	93	286	223
1988	101	97	276	202
1987	117	97	271	186
June 1989 Changes From:				
May 1989	-18.2%	3.1%	1.9%	23.4%
Jun 1988	-36.8%	6.5%	-6.6%	4.0%

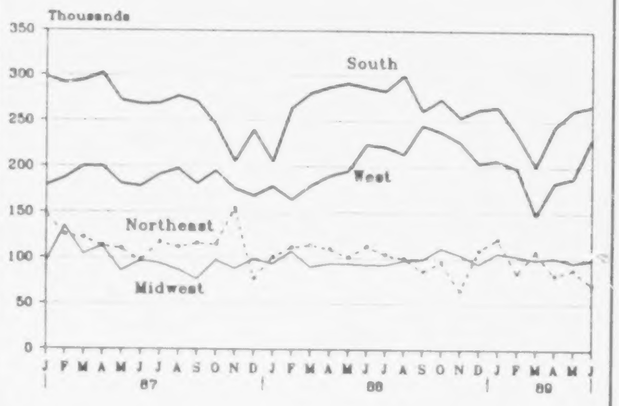
Source: Bureau of the Census, Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: The Bureau of Census; E NAR Estimates

GRAPH 10: NEW HOME SALES BY REGION



Source: The Bureau of Census

Sales of new single-family homes continued to rise in June, climbing 5.5 percent to a seasonally adjusted annual rate of 670 thousand units. Sales have risen 20.9 percent over the past three months, from their 1989 low of a 555 thousand unit annual rate set in March. However, even with the encouraging sales activity of recent months, new home sales remain 4.3 percent below the January 1989 rate of 700 thousand units and 6.4 percent below the rate of a year ago. Putting annual rates aside, sales totaled 342 thousand units in the first six months of 1989, compared with 363 thousand during the first half of last year.

The recent steady rise in new home sales has not been shared by all four regions. On the contrary, sales in the Midwest have stagnated in 1989, while in the Northeast sales have plunged 40.5 percent since January. On the other side of the ledger, new single-family home sales in both the South and West have rebounded beyond their January 1989 levels. In the case of the West, sales were up 4 percent over June of 1988. However, at the midpoint of 1989, only the Midwest has reported a 1989 first half increase in total new home sales over the first six months of 1988. In the first six months of 1989, total sales were down 16.1 percent in the Northeast, 10 percent in the South and unchanged in the West.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Jun 1989	3400	Nov 1988	3710
May 1989	3210	Oct 1988	3680
Apr 1989	3400	Sep 1988	3650
Mar 1989	3400	Aug 1988	3690
Feb 1989	3480	Jul 1988	3650
Jan 1989	3550	Jun 1988	3800
Dec 1988	3920		

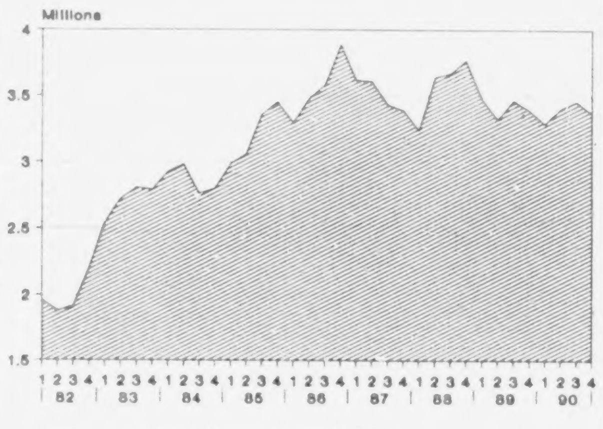
Jun 1988 Changes From:		Annual Totals:	
May 1989	5.9%	1988	3594
Jun 1988	-10.5%	1987	3526

REGIONAL DATA

	Northeast	Midwest	South	West
Jun 1989	550	960	1280	610
May 1989	610	810	1230	580
Apr 1989	610	890	1280	620
Mar 1989	570	870	1270	670
Feb 1989	600	920	1310	640
Jan 1989	710	930	1310	630
Dec 1988	700	1010	1500	700
Jun 1988	720	1000	1410	680
1988	673	929	1350	642
1987	685	959	1282	600
Jun 1989 Changes From:				
May 1989	-9.8%	18.6%	4.1%	5.2%
Jun 1988	-23.6%	-4.0%	-9.2%	-10.3%

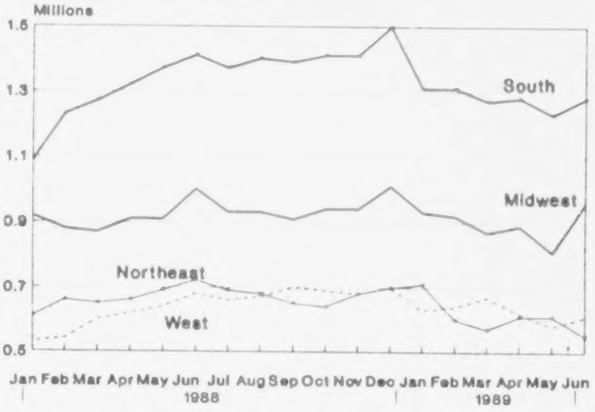
Source: NATIONAL ASSOCIATION OF REALTORS®, Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: The Bureau of Census; E NAR Estimates

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics and Research; E NAR Estimates

Encouraged by lower mortgage rates, sales of existing single-family homes moved forward for the first time in 1989, rising 5.9 percent in June to an annual rate of 3.4 million. Fixed rate mortgages fell to an average of 10.07 percent in June, slightly easing the affordability crunch which has kept many potential buyers out of the market since late last year. And while the healthy sales increase (the largest monthly climb in 32 months) showed housing demand remains buoyant, we do not expect further large gains in the coming months, despite continued interest rate declines which had brought fixed rate mortgages to 9.87 percent at the end of July. Slow employment growth and a sluggish economy will most likely keep the monthly home sales numbers between 3.3 million and 3.5 million units throughout the second half. Sales of existing single-family homes are forecasted to improve modestly in the next few months before falling again at the end of this year.

Regionally, sales picked up in every region except the Northeast, with the Midwest recording the largest gains. The housing market in the Northeast continues to struggle under the weight of high housing costs. Sales in the Northeast dropped 9.8 percent in June, and are 23.6 percent below the 720 thousand unit annual rate set last June. Meanwhile, sales in the Midwest jumped 18.6 percent to an annual rate of 960 thousand units, their strongest rate of 1989. Sales in the West and South were up 5.2 percent and 4.1 percent, respectively. Even with the pick up in home sales, none of the four regions posted gains over the sales rates set in June of 1988.

SINGLE-FAMILY HOME PRICES

	Median		Average	
	Existing	New	Existing	New
Jun 1989	$93,200	$129,900	$118,700	$159,100
May 1989	92,600	120,000	118,000	146,800
Apr 1989	92,900	117,600	118,000	144,500
Mar 1989	92,000	123,000	116,100	149,000
Feb 1989	91,900	118,000	117,800	145,300
Jun 1988	$90,200	$111,500	$115,400	$136,500
1988	89,300	112,500	112,800	138,300
1987	85,600	104,500	106,300	127,200
Jun 1989 Changes From:				
May 1989	0.6%	8.2%	0.6%	8.4%
Jun 1988	3.3%	16.5%	2.9%	16.6%

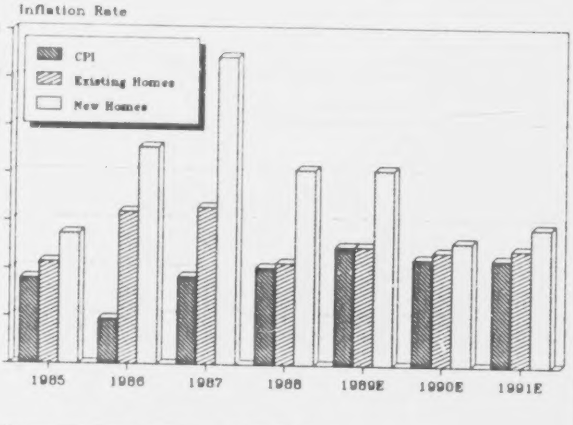
REGIONAL DATA

MEDIAN SALES PRICE OF AN EXISTING HOME

	Northeast	Midwest	South	West
Jun 1989	$149,800	$72,100	$84,900	$134,100
May 1989	143,800	70,300	84,100	142,300
Apr 1989	144,000	70,400	85,200	142,700
Mar 1989	143,600	69,900	84,000	138,000
Feb 1989	142,600	69,900	86,700	127,800
Jun 1988	$147,300	$70,000	$83,900	$127,000
1988	143,000	68,400	82,200	124,900
1987	133,300	66,000	80,400	113,200
Jun 1989 Changes From:				
May 1989	4.2%	2.6%	0.9%	-5.8%
Jun 1988	1.7%	3.0%	1.2%	5.6%

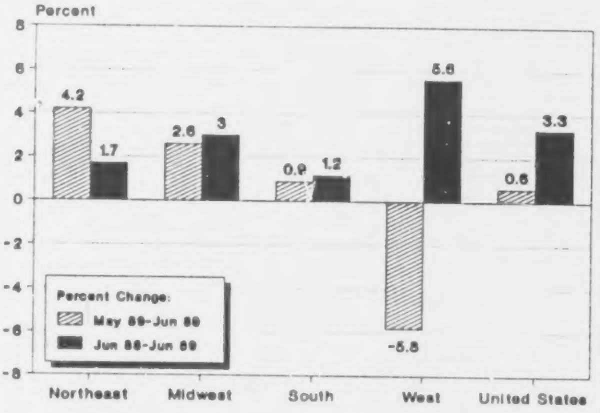
Source: NATIONAL ASSOCIATION OF REALTORS®,
Economics and Research Division

GRAPH 13: HOME PRICES



Source: The Bureau of Census; E NAR Estimates

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics and Research; E NAR Estimates

Despite the surge in existing home sales, prices increased only modestly in June, creeping up 0.6 percent to a median price of $93,200. The median price of a new home jumped 8.2 percent to $129,900, or 16.5 percent above the median price of a year ago. The moderate increase in the price of an existing single-family home is probably explained by the easing of affordability pressures during June. As declining interest rates made it possible for lower-income prospective homebuyers to qualify for a mortgage, their purchases of modestly priced homes most likely kept the median sales price from rising substantially, despite increased demand. Moreover, much of the increase in sales activity occurred in the Midwest, where homes are priced well below the national median.

Prices of existing single-family homes rose in three out of the four regions, with the Northeast reporting the largest gains. The median sales price of an existing home in the Northeast rose 4.2 percent in June to $149,800. However, even with this substantial one month climb prices were only 1.7 percent above the median of a year ago. The sales price of the median home in the West dropped 5.8 percent from May to June, but was 5.6 percent above the June 1988 median price. The Midwest is the only region where prices have risen for three consecutive months, rising 2.6 percent in June to $72,100. Prices inched up 0.9 percent in the South to $84,900.

Sean A. Burns, Director of Forecasting
Beth M. Maerz, Research Associate

INFLATIONARY DISTORTIONS AND REAL ESTATE PROVISIONS

The purpose of the depreciation allowance is to write off the portion of the cost of a depreciable asset that is used up in producing the income of the firm. However, during inflationary periods, depreciation deductions based on historical costs will not permit the tax-free recovery of the cost of the asset as it wears out.

Several proposals have been suggested by economists to correct depreciation for inflation. The first proposal would allow depreciation deductions based on replacement costs (based on an official index). The second proposal would allow the historical cost to be adjusted for inflation as measured by the rise in the average of all prices. The final proposal would allow an immediate deduction for the present value of the future economic depreciation that firms could claim. The three proposals are effectively identical if the replacement price of the asset rises by the same amount as the average of all prices.

Inflation and Depreciation Deductions

The depreciation deduction is distorted during inflationary periods because inflation reduces the real value of the deduction. As mentioned before, this distortion occurs because under current law, depreciation is based on the historical cost of the productive asset.

For example, assume a piece of equipment (Capital good A) purchased for $10,000, is expected to last for 10 years, and is assumed to depreciate at the rate of 10 percent per year (straight line). This means that the firm will deduct $1,000 a year for 10 years as depreciation deduction for tax purposes.[1] Also assume that the real interest rate (which is approximately, the market interest rate minus the inflation rate) is 4 percent. The present value of the depreciation deduction for this equipment is $8,111 if there is no expected inflation. However, as Table 1 indicates, the present value of the depreciation deduction for this equipment becomes smaller as inflation increases. In fact, the deduction falls to almost half its real value under a 15 percent inflation rate scenario. Thus, the interaction between inflation and the depreciation deduction reduces the incentive to invest in productive assets during inflationary periods.

The interaction of inflation and historical cost depreciation deductions also distorts investor preferences towards short-lived assets. For example, consider a case where an investor has a choice of investing in two capital goods which produce the same output, both in quantity and quality. Capital good A has a useful life of 10 years and costs $10,000. Capital good B has a useful life of 2 years and costs $2,000.[2] With no inflation, both capital goods would yield the same real value of depreciation deductions. However, capital good B becomes more attractive relative to capital good A in the presence of inflation as Table 1 illustrates. The present value of the depreciation deductions (for a ten year period) is higher for the shorter-lived asset (capital B) during inflationary times.

Inflation Indexation

If the depreciation deduction is adjusted by indexing the historical cost of the productive asset, then the real value of the depreciation deduction will not be sensitive to the inflation rate. Table 2 shows the depreciation deduction that would be taken under the indexation proposal under alternative inflation rate assumptions and is applicable for both capital goods A and B. While a greater nominal amount must be taken each year as a deduction for greater rates of inflation, the present value of the deductions are the same regardless of the inflation rate. Moreover, the present value is independent of the life of the asset. Thus, indexing the cost of the asset for inflation eliminates the incentive to reduce investments in depreciable productive assets and makes the choice of asset-life inflation neutral.

Other Aspects of Depreciation Deduction

The previous analysis ignored current tax law treatment of depreciation by assuming that the depreciation based on historical cost is allowed at the "true" rate. Deviations of tax depreciation from true, or economic depreciation will affect investor behavior. If tax depreciation is allowed at a faster rate than economic depreciation, investment will be stimulated. However, the incentive to invest will be reduced if depreciation is allowed at a slower rate under the tax law than economic depreciation.

Accelerated depreciation methods have been justified in the past on the grounds of inflation. However, they are only an approximation to actual adjustments for inflation and can only achieve this goal accidentally. To illustrate this point, let us go back to capital good A, which has a useful life of 10 years and is assumed to have a true depreciation pattern that is straight line. Recall that the present value of the inflation indexed depreciation deductions is $8,111. If the tax-life of capital good A is shortened to 5 years (straight line), it would roughly correct for inflation at the rate of 3 percent, but shorter tax lives are required to compensate for higher inflation rates (see Table 3). On the other hand, at very low inflation rates close to zero, a 5 year tax-life would be overly generous.

Tax depreciation can also deviate from economic depreciation if the allowed method of tax depreciation is different from the true pattern of depreciation. Over the years, several methods of depreciation have been allowed under the tax code. The straight-line method simply allows the cost of the asset to be spread evenly over its useful life. The declining-balance method and the sum-of-the-years' digits method assume that a larger share of the total depreciation occurs in the earlier years. Table 4 illustrates the differences in the three methods.

The alternative methods have implications for the real value of the depreciation deduction and investor behavior. If the true pattern of depreciation is straight-line, then the alternative methods will give the taxpayer a depreciation deduction that is greater than necessary. However, if the true pattern is double-declining balance, or sum-of-the-years' digits, then tax depreciation under the straight-line method would not allow the total cost of the depreciable asset to be recovered tax-free. If the true pattern of depreciation is not reflected in the tax law, inflation may either increase or decrease the bias. For example, if the true pattern of depreciation is straight-line, use of double-declining balance for tax purposes would alleviate the distortion caused by inflation to a certain degree. However, if the reverse were true, the distortion would be exacerbated.

Conclusion

The presence of inflation reduces the real value of depreciation deductions for tax purposes, making investments in depreciable assets less attractive during inflationary periods. Economists have proposed several methods of dealing with the inflation, but these proposals have not been adopted. However, some economists have observed that the government appears to be pursuing the ad hoc strategy of dealing with inflation by changing the tax depreciation schedules in response to a change in inflation.[3] These ad hoc strategies can only approximately correct for inflation, and in many cases, will under-correct for inflation.

by
T. Emi Miyake
Director of Tax Research
Forecasting and Policy Analysis

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[1] This also assumes that the tax law requires depreciation to be deducted at the "true" rate.

[2] This example taken from Yeats, Kevin, "The Tax Treatment of Real Estate Depreciation" National Association of Realtors® Research Paper, July 1988.

[3] See Follain, James R., Hendershott, Patric H. and Ling, David C., "Understanding the Real Estate Provisions of Tax Reform: Motivation and Impact" National Tax Journal Vol XL, No. 3, 1988: 363-372, for evidence of this strategy.

Table 1
Present Value[1] of Depreciation Deduction Under Alternative Inflation Rates

	Inflation Rates				
	0%	3%	5%	10%	15%
Capital Good A[2]	8,111	6,985	6,362	5,136	4,250
Capital Good B[3]	8,111	7,762	7,544	7,045	6,602

[1] Based on a 10 year period

[2] Assumed to cost $10,000 with a useful life of 10 years, 4% real interest rate

[3] Assumed to cost $2,000 with a useful life of 2 years, 4% real interest rate.

Table 2
Depreciation Deduction with Indexation for Inflation

Time	Inflation rates				
Period	0%	3%	5%	10%	15%
1	1,000	1,030	1,050	1,100	1,150
2	1,000	1,061	1,103	1,210	1,323
3	1,000	1,093	1,158	1,331	1,521
4	1,000	1,126	1,216	1,464	1,749
5	1,000	1,159	1,276	1,611	2,011
6	1,000	1,194	1,340	1,772	2,313
7	1,000	1,230	1,407	1,949	2,660
8	1,000	1,267	1,477	2,144	3,059
9	1,000	1,305	1,551	2,358	3,518
10	1,000	1,344	1,629	2,594	4,046
TOTAL	10,000	11,808	13,207	17,531	23,349
Present Value	8,111	8,111	8,111	8,111	8,111

Table 3
Effects of Accelerated Depreciation Under Alternative Inflation Rates

	Inflation Rates				
	0%	3%	5%	10%	15%
Present Value Under 10 Year Depreciation Schedule	8,111	6,985	6,362	5,136	4,250
Present Value Under 5 Year Depreciation Schedule	8,904	8,174	7,739	6,801	6,034

Assumptions: Purchase Price of $10,000. Useful life of 10 years. Tax life of 5 years. 4% real interest.

Table 4
Comparison of Depreciation Methods

	Straight Line	Double Declining Balance[1]	Sum-of-the-years' Digit
1	1,000	2,000	1,818
2	1,000	1,600	1,636
3	1,000	1,280	1,455
4	1,000	1,024	1,273
5	1,000	819	1,091
6	1,000	655	909
7	1,000	655	727
8	1,000	655	545
9	1,000	655	364
10	1,000	655	182
TOTAL	10,000	10,000	10,000
Present Value at 4% real interest and inflation rate at:			
0%	8,111	8,487	8,587
3%	6,985	7,560	7,700
5%	6,362	7,037	7,191
10%	5,136	5,979	6,142
15%	4,250	5,182	5,334

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[1] With switch to straight line when profitable.

INCREASING SINGLES AND AGING "BOOMERS" --

Impacts on Household Finances and Implications for Housing

The demographic composition of the U.S. population is generally accepted as a force behind overall consumption types and levels, savings rates, household formation and numerous other phenomena. There are two particularly noteworthy changes occurring now and projected to increase in the future. The first is the passage of the baby boomers, those individuals born between 1946 and 1964 when the population was increasing especially rapidly, through middle age; the second is the prognosis for continued strong growth in the share of single-person households. While these phenomena will impact many areas such as education, transportation, etc., this article will focus on their impacts on household financial resources and the implications for household formation and housing.

Financial Resources -- Profiles of Select Household Types

Access to financial resources is critical to a household's initial formation and then to purchasing or renting suitable housing. Financial resources include the flows of wage and salary income, dividends and interest, capital gains, government subsidies, social security and private pension benefits, child support, and alimony. But they also include stocks of household assets, net wealth, and savings. The cost of forming a household is determined by house prices; contract rents; mortgage rates, instruments and underwriting criteria; utility, fuel, maintenance and repair costs; property insurance; real estate taxes; and closing costs on home acquisition.

If costs of household formation are high relative to financial availability, young people often will delay household formation. This phenomenon was evident during the early 1980s when mortgage rates peaked at nearly 15 percent (1982), thereby increasing the cost of housing and homeownership. After increasing by an average of 1.51 million per year from 1975 to 1980, total U.S. households grew by only 1.31 million per year during the first half of the 1980s.

A household's ability to rent or purchase housing depends primarily on its income, either to make rental payments or to meet ongoing expenses of homeownership, i.e., to meet principal and interest payments on mortgages, real estate taxes, insurance, maintenance and repairs, and fuel and utility expenses. In addition, the ability of a household to make the transition to homeownership depends primarily on having stocks of household wealth and savings adequate to meet the often formidable upfront home acquisition costs of equity downpayment, prepaid interest expenses, prepaid mortgage insurance premiums, transfer taxes, and other fees for services associated with closing the home sale.

The 1983 and 1986 Surveys of Consumer Finances give insight into the financial, and changing financial, positions of U.S. households, particularly those features most integral to household formation, housing purchases, and homeownership.[1] Tables 1 through 3 provide snapshots of the financial positions of four household types -- single-person, all married couples, married couples without children, married couples with children -- within three age cohorts: households headed by members born from 1946 to 1964; households headed by members born from 1925 to 1945; and households headed by members born before 1925.[2] We will refer to the first group as they are commonly called "baby boomers," the second group as the "pre-baby boom generation" and the third group as the "elderly."[3]

An important determinant of housing affordability is net worth/wealth. Tables 1 through 3 indicate that married owners of each type and in each age cohort had greater 1986 net worth, excluding home equity, than did their renting counterparts. (Unless otherwise indicated, net worth comparisons do not include homeowners' net equity in their homes.) The 1986 net worth of married owners ranged from $18,379 for baby boomers with children at home to $54,783 for pre-baby boomers with children at home. The 1986 typical net worth of married renters was far less than for owners, ranging from $3,865 for pre-baby boomers with children to $35,030 for pre-baby boomers without children.

Inclusion of home equity in the 1986 net worth of homeowners widens the gap in net worth between married owners and married renters, demonstrating the importance of home equity in household wealth accumulation. (See Tables 1 through 3.) When home equity is included, typical net worth of married owners in the pre-baby boom and elderly generations is in the $100,000 to $128,000 range. With less time to have accumulated home equity, married owners of the baby boom generation had about half as much wealth -- $51,446 for marrieds without children and $51,628 for marrieds with children living at home.

Tables 1 through 3 also show that single-person households which own generally possessed greater net worth in 1986 than did single-person households which rent. Among baby boomers, single owners had roughly three times more net worth, on average, than did single renters, $27,065 vs. $9,000; when home equity is included, the gap widens to $46,290 vs. $9,000. The difference in net worth between single owners and single renters is even more pronounced for the pre-baby boom generation, $16,025 vs. $2,149; when net home equity is included, the gap becomes $52,003 vs. $2,149. The story is similar for the elderly --

$2,067 in 1986 net worth for the typical single renter, $9,500 in 1986 net worth for the typical single homeowner, and $60,088 when home equity is included in the net worth of the typical single homeowner.

Tables 1 through 3 show that single owners in the baby boom generation typically had greater net worth than did single owners in older generations despite their having had less time to accumulate wealth. Single owners in the baby boom generation typically had net worth of $27,065 vs. $16,025 for the pre-baby boom generation and $9,500 for the elderly. When home equity is included, the baby boomers still fare well, lagging the pre-baby boom generation by only $6,000 ($46,290 vs. $52,003) and the elderly by only $14,000 ($46,290 vs. $60,088).

An important aspect of net worth, particularly concerning renters' ability to purchase homes, is its liquidity, or ease of conversion to home downpayment and closing costs. Tables 1 through 3 show that for each age cohort, married owners typically have larger amounts of liquid assets than do married renters.[4] The many married baby boom renters would seem to be highly prospective homeowners. However, in 1986 their median liquid assets ranged from $500 for marrieds with children at home to $2,000 for marrieds without children at home, not large amounts relative to upfront cash needed to purchase a home in most housing markets.

Greater liquidity of owners than of renters is not limited to married households. Tables 1 through 3 also indicate that financial portfolios of single owners include more liquid assets than do portfolios of single renters. Among the pre-baby boom generation, single owners had median liquid assets over three times as large as for single renters ($3,500 vs. $1,025). Likewise among the elderly, single owners had median liquid assets of $5,601 compared with $378 for single renters. Among baby boomers, single owners had a median $10,000 of liquid assets, single renters $3,500.

That the $10,000 in liquid assets for single owner, baby boomers compares favorably with the liquid assets of both the pre-baby boom and elderly married owners is interesting for two reasons. First, liquid assets of married households would be expected to be higher than those of single-person households due to two-earner households in many cases. Second, pre-baby boom and elderly households have had considerably more time to accumulate liquid assets than have baby boomers. This may indicate an affluent group of single-person households, or it may simply indicate less of a preference for liquidity by married and older households.

While net worth and liquid assets primarily affect a household's ability to make the transition from renting to owning, household income has greater implications for a household's ability to maintain ongoing expenses of renting or owning. Tables 1 through 3 reveal average incomes for each category of owners that are greater than for corresponding renters.[5] Average incomes ranged from $5,840 for elderly single renters to $36,667 for pre-baby boom married owners with children at home. Moreover, for married owners and renters, incomes appear to follow the life-cycle; for single owners and renters, incomes do not.

The savings rates (as measured by the change in net worth from 1983 to 1986 as a percent of income) of homeowners, shown in Tables 1 through 3, are higher in most cases than the savings rates of renters.[6] The savings rates of homeowners, excluding change in their net home equity, ranged from 0.0 percent for elderly single owners to 19.5 percent for single owners of the baby boom generation. (Unless otherwise indicated, savings rate comparisons do not include homeowners' changes in net equity in their homes.) This 19.5 percent saving rate is high relative to the savings rates of the single owners of the other age cohorts, 1.5 percent for the pre-baby boomers and 0.0 percent for the elderly. It is also high relative to the savings rate for married owners of the same generation.

When change in net home equity is included in savings, homeowners of each age cohort had savings rates between 15 and 25 percent (except for elderly marrieds with children at home, who had a savings rate of 7.3 percent). In contrast, savings rates of renters ranged from -0.5 percent for elderly single renters to 9.2 percent for single renters of the baby boom generation.

Both single and married renters of the baby boom generation appear to save more than did their predecessors, perhaps indicating their greater affluence or greater preference for future consumption. While baby boom renters had typical savings rates of about 6.0 percent for marrieds and 9.0 percent for singles, typical savings rates for pre-baby boom renters and elderly renters were significantly lower, ranging from -0.5 percent for elderly singles to 3.5 percent for elderly marrieds.

Household Financial Profiles -- Implications for Housing

What implications for the housing market can we draw from the evidence presented? Typically, for two of the age cohorts, married households from the 1983 and 1986 Surveys of Consumer Finances have substantially more net worth/wealth than other household types, perhaps due to dual earners in many cases. If this relationship between married couple households and net worth remains true, then the prognosis for increasing single-person households could result in more households with less wealth per household. This would likely yield an increased demand for rental units and/or less expensive (due to less square feet, fewer amenities, etc.) owner-occupied units. The single baby boomers, however, appear to be a more affluent group than the single-person households of preceding generations. For both owners and renters, the 1986 net worth of single baby boomers is typically even greater than that of married baby boomer households which often have two earners. Even when home equity is considered, the net worth of single owners lags that of married owners of the baby boom by only a little. This may indicate that the singles of the baby boom generation are more the career professionals who have postponed marriage, while more of the singles of previous generations are those who are divorced or those who postponed or forewent marriage and family due to their inability to support such a household. If many of the single-person households of the baby-bust and subsequent generations are as affluent as the singles of the baby boom appear to be, then the forecast growth in single-person households will not likely have negative implications on the demand for homeownership.[7]

Incomes of the three age cohorts augur well for household formation in that household incomes appear to follow the life-cycle. That is, income for the pre-baby boom generation is higher than the other two age cohorts. If this pattern holds, then incomes will increase for the swollen ranks of the baby boomers entering their peak earning years.[8] Increasing income would make household formation more affordable, thereby increasing it. The split of the newly formed households between renters and owners would depend to some extent on the magnitude of the increase in income relative to the fixed costs of running a household. Housing costs have outpaced income in recent years in many markets, thereby decreasing renters' abilities to save for homes.

No clear pattern emerges on the savings rates of our three age cohorts, perhaps due to the way in which the rates are calculated. (Their calculation is also most likely the reason why they appear higher than those often quoted.) For example, among both owner and renter single-person households, baby boomers had the highest savings rates of the three cohorts. The high savings rates for single renters of the baby boom would suggest that, given the desire to do so, many of them will be able to buy homes in the near future. The high savings rate of single homeowners of the baby boom suggests that, given the desire to do so, many of them are well-positioned to "trade-up" to more expensive homes. The "trade-up" market should be helped further if the savings of the married homeowners of the baby boom match the savings of the pre-baby boom generation at the same age.

I would like to dedicate this article to Daniel N. Chambers, formerly the Director of Housing Research, who died in June. His research ideas, editorial comments and suggestions on other studies guided me in writing this article.

By
Mary B. Schwartz
Housing Economist
Forecasting and Policy Analysis

1.The surveys were jointly sponsored by the Board of Governors of the Federal Reserve System and several other government agencies. For details on the surveys, see Robert B. Avery and Gregory E. Elliehausen, 1983 Survey of Consumer Finances: Technical Manual and Codebook, Board of Governors of the Federal Reserve System, and the corresponding 1986 manual by Avery and Arthur B. Kennickell.

2.Households for the following analysis include only what the U.S. Bureau of the Census defines as "primary individuals" or "families."

3.Unfortunately, the sample did not include enough households headed by members born after 1964, commonly referred to as the "baby bust", to provide reliable statistics for this group.

4.The only exception is among elderly married couples with children at home, wherein renters have more liquid assets than do owners. But the sample of elderly married couples with children at home who rent is too small to provide meaningful averages.

5.The elderly married couples with children at home are the exception but, as noted previously, their small number makes comparisons with this group unreliable.

6.This is consistent with findings of other studies. See Daniel N. Chambers and Mary B. Schwartz,"Owner-Renter Differences in Political and Social Involvement, Housing Maintenance and Savings Choices," research paper for the NATIONAL ASSOCIATION OF REALTORS®, (January 1989).

7.Of course, there are many other considerations such as the expected mobility of these increased singles. Because even if the successive generations of single-person households are affluent, studies have suggested that when a household's expectation of moving in the near future is high, its probability of purchasing a home is low. This would tend to increase the demand for rental housing. See John Simonson, "Prospective First-time Homebuyers: Salient Characteristics and Their Implications," research paper for NATIONAL ASSOCIATION OF REALTORS®, (February 1989).

8.The counter argument is that the income shares of different age groups are relatively stable over time. So that the increase in income share due to an increase in the share of the population in their "peak earning" years would be offset by lower wages due to decreased demand for workers in this age group.

Table 1

FINANCIAL PROFILE OF BABY BOOMERS, BY TENURE AND MARITAL STATUS, 1986[a] (Except where noted, values are medians)

	Owners				Renters				
	Single	All Married	Married w/o Children	Married w/ Children	Single	All Married	Married w/o Children	Married w/ Children	All Baby Boomers
Liquid Assets[b]	$10,000	$3,050	$5,500	$3,000	$3,500	$800	$2,000	$500	$2,000
Net Worth (w/o home equity)	46,290 (27,065)	51,538 (18,975)	51,446 (23,454)	51,628 (18,379)	9,000	5,541	7,228	5,003	20,634 (9,480)
Income[c]	23,333	30,333	30,500	30,000	21,489	18,000	20,667	16,967	22,333
Savings Rate[d] (w/o change in home equity)	23.7% (19.5%)	17.3% (7.3%)	21.5% (12.4%)	17.0% (6.9%)	9.2%	5.5%	6.3%	5.2%	9.2% (5.3%)
Number of Households	40	484	76	408	80	117	27	90	947

NOTE: All of the households broken down by owner/renter in the Table are "families" or "primary individuals" as defined by the U.S. Bureau of the Census. However, due to the inclusion of an additional 226 non family and non primary individual households, the number of "All Baby Boomers" is not equal to the sum of single owners, all married owners, single renters and all married renters. Households from both the area probability and high income samples are included. Also, only households which were in both the 1983 and 1986 Surveys of Consumer Finances are included.

[a] Households headed by members born between 1946 and 1964, inclusive.

[b] Liquid assets include stocks and mutual funds, bonds, checking and savings accounts and money market accounts and CDs.

[c] Income is the average of the median 1983, 1984 and 1985 annual incomes. It is probably best viewed as a measure of "permanent income."

[d] Savings rate is calculated as the change in household net worth from 1983 to 1986 as a percent of household income from 1983 through 1985. The first savings rate includes the change in home equity; the parenthesized rate does not.

Source: 1983 and 1986 Surveys of Consumer Finances, Board of Governors of the Federal Reserve System (tabulations of unpublished data).

Table 2

FINANCIAL PROFILE OF PRE-BABY BOOM GENERATION, BY TENURE AND MARITAL STATUS, 1986[a] (Except where noted, values are medians)

	Owners				Renters				
	Single	All Married	Married w/o Children	Married w/ Children	Single	All Married	Married w/o Children	Married w/ Children	All Pre-Baby Boomers
Liquid Assets[b]	$3,500	$8,400	$9,200	$8,300	$1,025	$1,000	$5,500	$400	$4,200
Net Worth (w/o home equity)	52,003 (16,025)	126,006 (51,620)	113,446 (47,230)	128,424 (54,783)	2,149	5,900	35,030	3,865	70,542 (22,628)
Income[c]	15,833	35,333	31,333	36,667	13,166	24,333	25,833	20,100	28,662
Savings Rate[d] (w/o change in home equity)	14.8% (1.5%)	22.7% (11.4%)	22.8% (8.7%)	22.7% (12.0%)	3.3%	2.4%	0.6%	2.6%	14.2% (4.8%)
Number of Households	83	699	263	436	62	90	62	28	1096

NOTE: All of the households broken down by owner/renter in the Table are "families" or "primary individuals" as defined by the U.S. Bureau of the Census. However, due to the inclusion of an additional 162 non family and non primary individual households, the number of "All Pre-Baby Boomers" is not equal to the sum of single owners, all married owners, single renters and all married renters. Households from both the area probability and high income samples are included. Also, only households which were in both the 1983 and 1986 Surveys of Consumer Finances are included.

a Households headed by members born between 1925 and 1945, inclusive.

b Liquid assets include stocks and mutual funds, bonds, checking and savings accounts and money market accounts and CDs.

c Income is the average of the median 1983, 1984 and 1985 annual incomes. It is probably best viewed as a measure of "permanent income."

d Savings rate is calculated as the change in household net worth from 1983 to 1986 as a percent of household income from 1983 through 1985. The first savings rate includes the change in home equity; the parenthesized rate does not.

Source: 1983 and 1986 Surveys of Consumer Finances, Board of Governors of the Federal Reserve System (tabulations of unpublished data).

Table 3

FINANCIAL PROFILE OF ELDERLY BY TENURE AND MARITAL STATUS, 1986[a] (Except where noted, values are medians)

	Owners				Renters				
	Single	All Married	Married w/o Children	Married w/ Children	Single	All Married	Married w/o Children	Married w/ Children	All Elderly
Liquid Assets[b]	$5,601	$12,000	$15,000	$4,623	$378	$3,000	$3,000	$10,000	$5,601
Net Worth (w/o home equity)	60,088 (9,500)	110,093 (49,800)	112,691 (50,029)	100,135 (35,928)	2,067	11,000	11,000	24,376	59,898 (16,427)
Income[c]	8,230	17,920	16,000	21,000	5,840	15,543	11,319	25,000	12,115
Savings Rate[d] (w/o change in home equity)	20.4% (0.0%)	22.9% (9.2%)	24.0% (9.1%)	7.3% (9.3%)	-0.5%	3.5%	1.0%	10.9%	7.0% (1.0%)
Number of Households	171	412	366	46	78	22	20	2	776

NOTE: All of the households broken down by owner/renter in the Table are "families" or "primary individuals" as defined by the U.S. Bureau of the Census. However, due to the inclusion of an additional 93 non family and non primary individual households, the number of "All Elderly" is not equal to the sum of single owners, all married owners, single renters and all married renters. Households from both the area probability and high income samples are included. Also, only households which were in both the 1983 and 1986 Surveys of Consumer Finances are included.

a Households headed by members born before 1925.

b Liquid assets include stocks and mutual funds, bonds, checking and savings accounts and money market accounts and CDs.

c Income is the average of the median 1983, 1984 and 1985 annual incomes. It is probably best viewed as a measure of "permanent income."

d Savings rate is calculated as the change in household net worth from 1983 to 1986 as a percent of household income from 1983 through 1985. The first savings rate includes the change in home equity; the parenthesized rate does not.

Source: 1983 and 1986 Surveys of Consumer Finances, Board of Governors of the Federal Reserve System (tabulations of unpublished data).

U.S. ECONOMIC OUTLOOK AUGUST 1989

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	1989.1	1989.2	89.3	89.4	90.1	90.2	90.3	90.4	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5113	5195	5265	5340	5425	5497	5570	5647	4524	4881	5228	5535	5883
% Change	7.9	6.6	5.5	5.9	6.5	5.4	5.5	5.6	6.9	7.9	7.1	5.9	6.3
% Change (w/out inflation)	3.7	1.7	1.2	1.7	1.6	1.5	1.6	1.9	3.7	4.4	2.6	1.6	2.4
Consumer Price Inflation (CPI)	5.4	6.4	3.8	4.3	4.7	4.4	4.3	4.3	3.7	4.1	5.0	4.5	4.5
GNP Inflation (GNP Deflator)	4.0	4.9	4.1	4.1	4.8	3.9	3.7	3.7	3.1	3.3	4.4	4.2	4.0
Unemployment Rate - Civilian	5.2	5.3	5.4	5.4	5.5	5.6	5.7	5.7	6.2	5.5	5.3	5.6	5.4
Civilian Employment-Household Basis (millions)	116.9	117.3	117.5	117.8	117.9	118.1	118.4	118.7	112.4	115.0	117.4	118.3	119.8
Percent change	3.7	1.3	0.7	0.9	0.7	0.6	0.8	1.1	2.6	2.3	2.1	0.8	1.3
Index of Industrial Production	140.7	141.4	141.6	142.2	142.7	143.1	143.7	144.3	129.8	137.2	141.5	143.4	147.2
Manufacturing Capacity Utilization	84.4	84.1	83.6	83.2	83.2	83.8	84.1	84.6	81.0	83.6	83.8	83.9	86.5
Domestic Auto Sales	6.9	7.3	7.2	7.0	6.9	7.0	7.0	7.0	7.1	7.5	7.1	7.0	7.1
Federal Tax Receipts (NIPA) as % of GNP	20.3	20.3	20.1	20.1	20.6	20.6	20.6	20.6	20.1	19.9	20.2	20.6	20.6
Federal Expenditures (NIPA) as % of GNP	23.2	23.1	22.8	22.7	23.0	22.8	22.7	22.5	23.7	22.9	22.9	22.8	22.4
Deficit(NIPA)	-147.5	-145.0	-141.6	-134.4	-130.5	-122.7	-115.5	-107.9	-161.3	-145.9	142.1	-119.2	-104.4
as % of GNP	-2.9	-2.8	-2.7	-2.5	-2.4	-2.2	-2.1	-1.9	-3.6	-3.0	-2.7	-2.2	-1.8
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4515	4284	4485	4405	4315	4429	4486	4400	4648	4650	4422	4407	4448
Percent change – year ago	1.5	-2.0	-4.0	-6.1	-4.4	3.4	0.0	-0.1	-1.4	0.0	-4.9	-0.3	0.9
Existing Single-family Home Sales (thousands)	3477	3320	3465	3390	3290	3405	3455	3370	3526	3594	3413	3380	3445
Percent change – year ago	5.4	-8.9	-5.4	-10.1	-5.4	2.6	-0.3	-0.6	-1.1	1.9	-5.0	-1.0	1.9
Housing Starts (thousands)	1517	1351	1445	1441	1457	1457	1467	1465	1634	1495	1438	1461	1410
Percent change – year ago	2.8	-6.6	-1.5	-7.6	-4.0	7.9	1.5	1.7	-9.8	-8.5	-3.8	1.6	-3.5
Single-Family Units	1070	994	1051	1047	1056	1055	1063	1062	1156	1088	1040	1059	1034
Percent change – year ago	-2.3	-8.1	-0.9	-8.1	-1.2	6.2	1.1	1.5	-2.2	-5.9	-4.4	1.8	-2.4
Multi-Family Units	448	357	393	394	401	402	404	403	477	407	398	402	375
2-4 Family Units	59	52	57	57	58	58	58	58	65	59	56	58	54
Percent change – year ago	6.0	-10.4	-0.1	-12.7	-2.3	12.5	2.6	2.2	-23.0	-9.5	-4.7	3.5	-6.7
5+ Family Units	388	305	336	337	343	344	345	344	412	348	342	344	321
Percent change – year ago	19.2	-15.3	-3.6	-5.1	-11.7	12.5	2.6	2.2	-24.4	-15.6	-1.7	0.7	-6.7
New Single-family Home Sales (thousands)	625	638	655	605	570	585	607	592	671	677	631	589	639
Percent change – year ago	9.3	-1.1	-11.8	-8.3	-10.9	-8.5	-4.9	-5.9	-10.5	0.9	-6.8	-6.7	8.5
HOME PRICES													
Existing Home Prices - Median $(1000)	91.2	92.9	94.9	96.1	96.6	97.5	99.3	99.7	85.6	89.3	93.8	98.3	103.1
Percent change – year ago	3.9	4.5	5.2	8.3	5.9	5.0	4.6	3.7	6.6	4.3	5.0	4.8	4.9
New Home Prices - Median $(1000)	118.0	122.2	123.1	123.7	124.7	127.2	129.5	131.0	104.0	112.5	121.8	128.1	135.5
Percent change – year ago	4.5	8.2	7.1	7.8	5.7	4.1	5.2	5.9	13.0	8.2	8.3	5.2	5.8
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.9	10.5	9.9	9.8	10.0	10.1	10.3	10.3	10.2	10.5	10.2	9.3	9.3
1-year ARM (without buydown)	8.8	9.0	8.7	8.5	8.5	8.5	8.5	8.5	8.5	8.5	8.8	8.5	8.6
Corporate AAA Bond Rate	9.7	9.5	9.0	9.0	9.2	9.2	9.2	9.2	9.4	9.7	9.2	8.4	8.4
Government Bond Rate	9.0	8.7	8.3	8.3	8.4	8.5	8.5	8.5	8.6	9.0	8.4	7.6	7.6
Short-Term Interest Rates													
Federal Funds Rate	9.4	9.7	8.9	8.5	8.5	8.2	8.2	8.2	6.7	7.6	9.2	8.2	8.3
3-month T-Bill Rate	8.5	8.4	8.0	7.8	7.7	7.5	7.4	7.4	5.8	6.7	8.1	7.1	7.2
Prime Rate	11.0	11.4	10.8	10.4	10.3	10.0	10.0	10.0	8.2	9.3	10.9	10.0	10.0
Discount Rate	6.7	7.0	7.0	6.8	6.5	6.3	6.3	6.2	5.7	6.2	6.9	6.3	6.2
Value of the U.S. Dollar (Trade-Weighted Avg.)	96.0	100.4	98.4	96.1	94.3	92.8	91.6	90.7	96.9	92.8	97.7	92.4	88.7
Percent change	13.5	19.7	-7.7	-8.9	-7.4	-6.2	-5.0	-3.8	-13.6	-4.3	5.4	-5.5	-4.0

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz.

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REAL ESTATE OUTLOOK

Vol. 2, No. 9

September 1989

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- Economic activity was apparently much stronger in the second quarter than the government initially reported, prompting the U.S. Department of Commerce to revise its estimate of real GNP growth upward by a full percentage point to an annual rate of 2.7 percent.
- For the second month in a row, the Consumer Price Index advanced at the very modest pace of 0.2 percent, casting doubt on fears of accelerating inflation. Meanwhile, the Producer Price Index fell for the second month in a row, dropping 0.4 percent in July -- the largest one month decline in over three years.
- With the economy apparently shaking off the outward signs of a coming recession, the Fed found itself under far less pressure to ease up on interest rates over the past month. While the Fed has not taken any direct credit tightening action, it has also made it clear that it does not intend to make any further interest rate cuts in the near future.
- Starts of privately owned homes rose slightly in July to 1.43 million units. The July increase marks the second consecutive monthly advance and the fastest annual rate since February of this year.
- Sales of new single-family homes staged an impressive comeback in July, jumping 14.4 percent to a seasonally adjusted annual rate of 739 thousand units. The rise marked the fastest rate of sales since December 1986, when homes were sold at an annual rate of 768 thousand units and it was also the largest one month climb since March 1986.
- Mirroring the trend in starts and new home sales, the sales pace of existing homes picked up speed in July, rising 1.2 percent to a seasonally adjusted annual rate of 3.4 million units.
- As is usually the case during the summer months, the median price of an existing single-family home continued to rise in July, moving upward by 3.2 percent to $96,400. Moreover, the median existing home showed an annual appreciation rate (July 1988 to July 1989) of 6.3 percent.

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NATIONAL ASSOCIATION OF REALTORS®
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Forecasting & Policy Analysis Division
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Thrift Raiders of the Lost Ark

Economic Commentary

by
John A. Tuccillo
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Real Estate Finance

The events of the summer have been nothing short of dazzling. With the Orioles in first place, people travelling to Woodstock, the Who and the Stones packing in the crowds and Paul McCartney, Ringo Starr and The Dead also on tour, it could be 1969 rather than 1989. But the headlines -- at least the financial news -- have been dominated not by what's similar to twenty years ago, but rather what's different. In the late Sixties, thrift institutions were at their zenith, pulling mom-and-pop deposits into their street corner temples and financing the American Dream. Now they're in deep trouble and with the passage of FIRREA (don't ask what it stands for -- only twelve people in Washington know!) questions must be asked about the future of this industry and, more importantly, the future of real estate finance.

FIRREA is an enormous piece of legislation, one that Congress sweated over for nearly a year. Some of its provisions will become clear only in their implementation. We don't know, for example, the ultimate impact of the absorption of the Federal Home Loan Bank Board by the Treasury, or the manner in which the Resolution Trust Corporation (RTC) will operate (more on this later). But we can make some judgments about the immediate impacts of some of the key provisions of the law.

1) **There will be fewer thrift institutions.** It now appears that the RTC will use $20 billion of spending authority by September 30 to buy out high rate deposits at endangered thrifts. This is a significant first step that will lead to their disappearance. More importantly, FIRREA enhances the attractiveness of thrift acquisitions by allowing commercial banks to buy and then convert healthy institutions. This ought to lead to a sharp reduction in the numbers of thrifts over the next three years.
2) **Those that remain will be more conservatively managed.** FIRREA tightens up the qualified thrift lender (QTL) test to move surviving thrifts more firmly toward residential mortgage investment. The new level is 70 percent, with no credit for mortgage banking operations. In addition, thrifts will have to give themselves a New Year's present of tangible capital to the tune of 1.5 percent of assets. Capital is the saffron of the financial industry -- rare, expensive and a delight to the senses. To reach the FIRREA standards, institutions must either buy more capital, shrink, or shift their portfolios toward more liquid assets. Bet on the last two. The surviving thrift of the future may look curiously like the thrift of the past.
3) **The market for mortgage securities will change.** This is a good news, bad news story. As the thrift industry is wound- down, both the Federal Government and the healthy segment of the industry will be "cashing out." Clearly, the first assets to go -- the ones with the best market potential -- will be mortgage securities. We have already seen a widening of spreads between MBS and Treasuries; that will continue over the next eighteen months. That's the bad news. The good news is that rising capital standards for all institutions will whet the appetite of commercial banks for mortgage securities and allow the market to grow substantially over the long term. Moreover, with the continuing demand for ARMs by borrowers and the demise of many thrift institutions -- major ARM investors -- the securitization of these instruments will be the next great development area for the secondary market.

When these are added up, and other effects are added, it seems that the most probable future for real estate finance is the continuation of the evolution of the Eighties. As the thrifts got into more and more trouble, the system developed alternative delivery systems -- largely centered on the secondary market -- and "sealed off" the sick part of the body. That will continue regardless of the nature or number of surviving institutions.

But what about the RTC? Given the location of the properties held by the government, there is immense potential for the disposition process to wreak havoc on local economies. The tricky part here is that there is no generalized answer. In some markets, a return to health is best done by fire-selling all property. This "Yellowstone" approach would clean the whole market out so that six or twelve months later, new blossoms and wildlife can flourish. In others, confiscated properties must be fed in gradually, because the market is too frail to sustain major shocks. The challenge to the RTC is to find and execute on a location-by-location basis the proper disposition approach. Clearly this is a piece of the thrift resolution in which all REALTORS® have a vital interest.

One thing is certain: the RTC will have some time to mull over its strategy. The assets the government now owns are best visualized by envisioning the huge warehouse that serves as the final resting place for the Ark of the Covenant in *Raiders*. In the vastness of the collection, there are some treasures amidst the garbage, but it will take years to sort it all out. And maybe that's for the good of the Republic.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

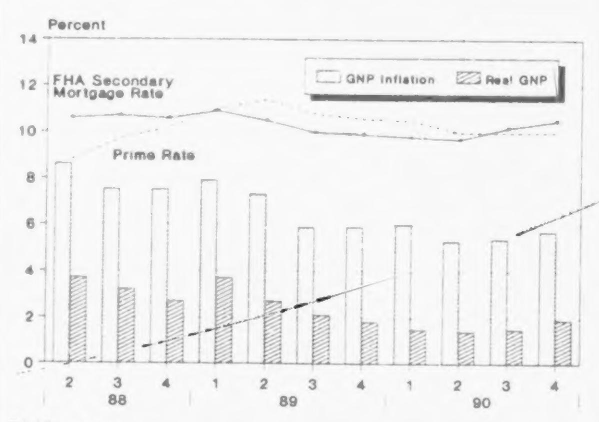
Economic activity was apparently much stronger in the second quarter than the government initially reported, prompting the U.S. Department of Commerce to revise its estimate of real GNP growth upward by a full percentage point to an annual rate of 2.7 percent. Aside from a healthy addition to the estimate of government spending, most of the GNP revision was spurred by a near doubling in the estimate of consumer spending, which increased by $14.3 billion in the second quarter rather than the previously reported $7.2 billion. Other encouraging revisions included smaller business inventory growth and slightly lower inflation: the annual rate of advance of the GNP price index was pegged at 5.1 percent, just under than the original estimate of 5.2 percent. This latest GNP report comes at a time when a host of monthly indicators suggest an upturn in economic activity during the mid-summer months. These new signs of economic strength have cast doubt on the likelihood of an economic recession during 1989, but have also reduced the chances of any further interest rate decreases by the Federal Reserve for the present.

Consumption Is Still In Vogue

The $7.1 billion revision to the consumer spending estimate confirms that the American consumer has not yet lost his appetite. Earlier this year, many analysts pointed to the then sagging consumption figures as a signal that consumer spending was on the retreat. However, it now appears the consumption slowdown was probably a reaction to a combination of unexpectedly heavy income tax payments, rising energy and food costs, and rising interest rates -- rather than an all out retreat on the part of the consumer. With all three of these burdens past, consumers have resumed spending patterns more typical of this economic expansion. However, while consumption of services and non-durable goods continues, demand for durable goods is expected to remain weak. The virtually uninterrupted spending of the past six years on consumer durable goods has most likely exhausted demand. Moreover, as today's generous car manufacturer and dealer incentives borrow from future sales, the rate of car sales is expected to slow again in the fall. Car buyers are likely to be further discouraged by safety-related price hikes in the 1990 models.

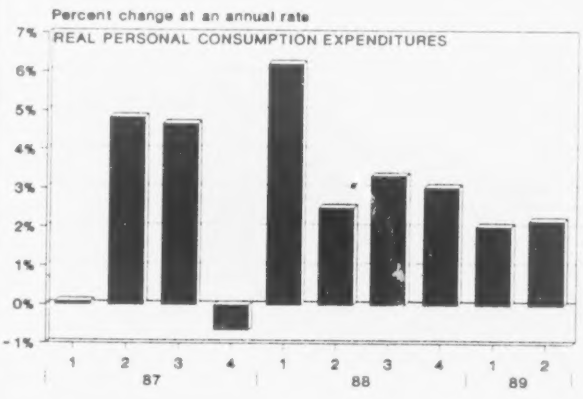
The national savings rate, while dipping slightly in the second quarter from 5.6 to 5.3 percent, has not suffered any major setbacks, despite the rise in consumption. In fact, savings as a percentage of disposable personal income has increased substantially from its low of 1.8 percent in the second quarter of 1987. Powerful demographic forces are likely at work here: baby boomers are moving into their 30's and 40's, which typically are peak years for earning and saving. At first glance, consumption growth and stronger savings would seem to be contradictory. However, the increases in both spending and savings have been encouraged by strong personal income growth, which rose 0.7 percent in August. Sources of continued personal income growth include the increased earning potential of the baby boomers as well as continued, uninterrupted employment growth. Payroll employment was up by an additional 110,000 jobs in August, an unexpectedly large figure given the 108,000 employees out on strike.

GRAPH 1: THE ECONOMIC OUTLOOK



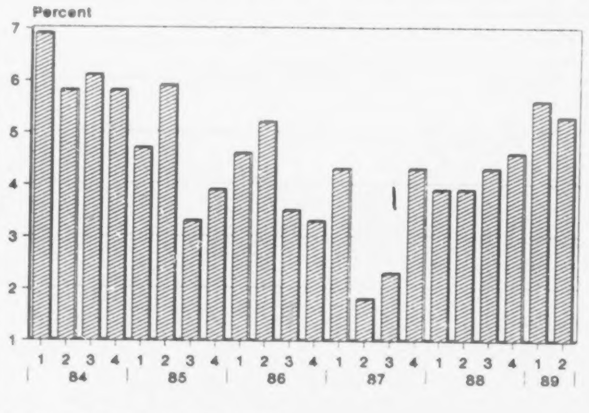
E NAR estimates

GRAPH 2: CONSUMERS CONTINUE TO SPEND



Source: Bureau of Economic Analysis.

GRAPH 3: SAVINGS TAKES UP A GREATER SHARE OF DISPOSABLE INCOME IN 1989



Source: The Bureau of Economic Analysis.

Inflation on the Retreat?

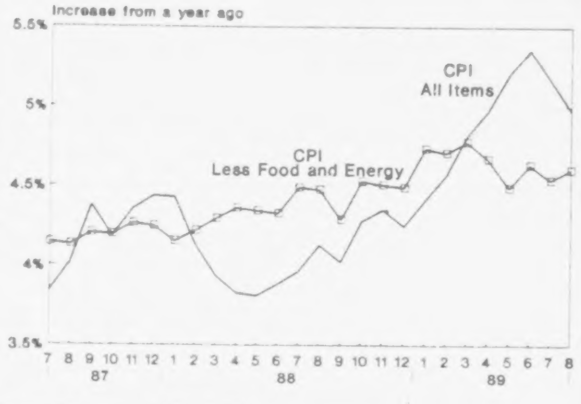
For the second month in a row, the Consumer Price Index advanced at the very modest pace of 0.2 percent, casting doubt on fears of accelerating inflation. Meanwhile, the Producer Price Index fell for the second month in a row, dropping 0.4 percent in July -- the largest one month decline in over three years. As encouraging as the recent inflation data may be, a closer look suggests that inflationary pressures must still be watched very carefully. During the spring and early summer, inflation measures were exaggerated by sharp increases in the cost of food and energy products. The recent slowdown of inflation is a reflection of the retreat in the cost of both of these goods. Graph 6 shows the rise in the Consumer Price Index for all goods, and then net of food and energy price changes, over the past two years. While recent movements in the general price level have been stimulated by food and energy costs, the rise of the CPI less food and energy products (many analysts consider this index to be a measure of the economy's core rate of inflation) had been rising steadily up until early spring of this year, where it leveled off at around 4.7 percent. While the Fed may have succeeded in stemming the rise of inflation, an inflation rate nearing 5 percent is not the stable price level Fed Chairman Alan Greenspan vowed to obtain more than a year ago.

MONETARY POLICY AND INTEREST RATES

As a result, perhaps no one is more conscious of the continued threat of inflation than the Federal Reserve. With the economy apparently shaking off the outward signs of a coming recession, the Fed found itself under far less pressure to ease up on interest rates over the past month. While the Fed has not taken any direct credit tightening action, it has also made it clear that it does not intend to make any further interest rate cuts in the near future. The result has been an upward drift in interest rates in recent weeks to approximately their level of late July. As dedicated as the Fed may be to reducing inflation to a level closer to 2 or 3 percent, it is unlikely that it will take any strong steps to lower inflation during the remainder of 1989. Instead, we expect that continued slow real growth will help ease short and long-term interest rates over the remainder of 1989.

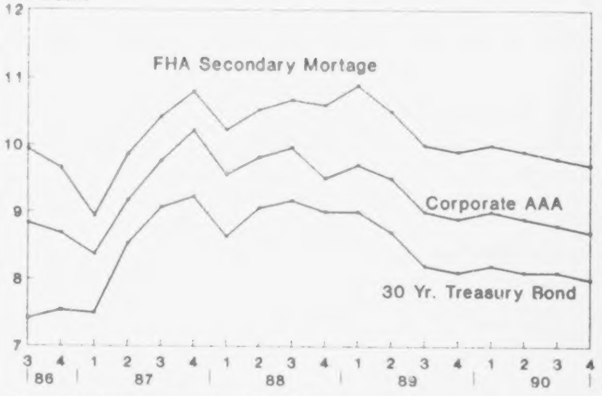
Against a backdrop of renewed economic activity and the apparent resolve of the Federal Reserve to hold credit tight, the value of the dollar has soared. Add to this the dollar rally of late May and early June, and the trade-weighted value of the dollar has risen 11.3 percent since January of this year. Foreign exchange markets have apparently disregarded not only central bank intervention (the New York Fed spent $12 billion between May and June trying to hold the dollar down with little or no effect), but also erratic improvement in the U.S. trade deficit. The dollar is expected to trade within a wide range over the closing months of 1989, as more information on the health of the U.S. economy and the extent of the Fed's resolve to fight inflation is revealed. However, the three other major industrial countries, including Japan, West Germany and Britain, may be planning interest rate hikes in response to inflationary troubles of their own. A concerted increase in interest rates by these three countries would seriously reduce the attractiveness of the dollar as well as its value.

GRAPH 4: THE CPI WITH AND WITHOUT FOOD AND ENERGY GOODS



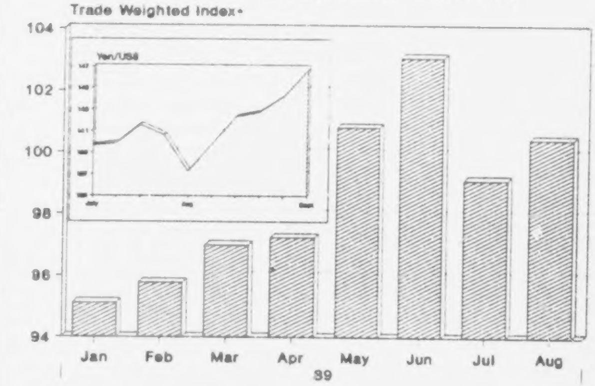
Source The Bureau of Labor Statistics

GRAPH 5: THE OUTLOOK FOR LONG-TERM INTEREST RATES



Source: The Federal Reserve Board; E NAR Estimates

GRAPH 6: THE DOLLAR SOARS AMIDST REPORTS OF ECONOMIC GROWTH



•March 1973=100

Source: Board of Governors of the Federal Reserve System.

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

		Total	S-F	2-4	5 and up
Jul	1989	1430	1041	59	330
Jun	1989	1419	979	56	384
May	1989	1308	977	42	289
Apr	1989	1343	1029	62	252
Mar	1989	1409	981	50	378
Jul	1988	1478	1067	50	361

Jul 1989 Changes From:

		Total	S-F	2-4	5 and up
Jun	1989	0.8%	-6.3%	5.4%	-14.1%
Jul	1988	-3.3%	-2.4%	18.0%	-8.6%

REGIONAL DATA

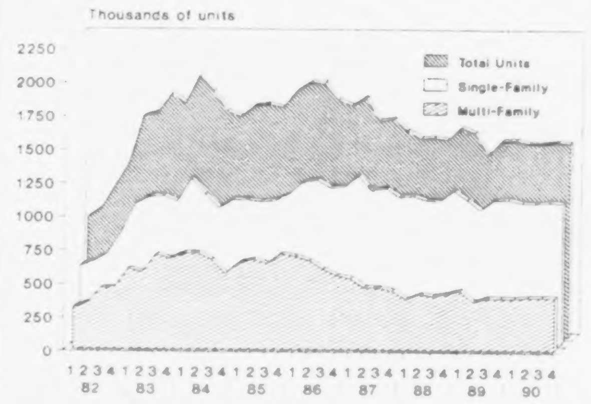
		Northeast	Midwest	South	West
Jul	1989	196	272	530	432
Jun	1989	169	245	554	451
May	1989	176	244	513	375
Apr	1989	207	274	526	336
Mar	1989	160	308	552	389
Jul	1988	255	283	566	374

Jul 1989 Changes From:

		Northeast	Midwest	South	West
Jun	1989	16.0%	11.0%	-4.3%	-4.2%
Jul	1988	-23.1%	-3.9%	-6.4%	15.5%

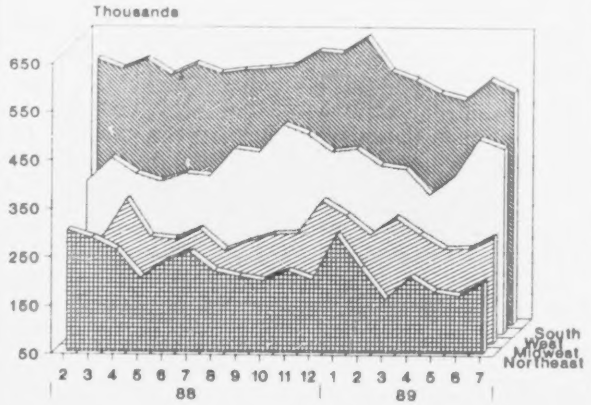
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: The Bureau of Census; E NAR Estimates

GRAPH 8: HOUSING STARTS BY REGION



Source: The Bureau of Census

Starts of privately owned homes rose slightly in July to 1.43 million units. The July increase marks the second consecutive monthly advance and the fastest annual rate since February of this year. The 0.8 percent increase followed a revised 8.5 percent jump in starts during June, when homes were started at an annual rate of 1.419 million units. However, unlike the June increase, which was fueled almost entirely by the 32.9 percent jump in starts of multi-family units, the step up in starts during July was encouraged by the 5.4 percent rise in starts of single-family homes; while multi-family starts dropped by 11.6 percent. The uptick in single-family starts is likely the result of falling interest rates during June and July. Further advances in housing starts during 1989 are expected to be modest as interest rates close the year at levels at or slightly higher than those experienced during late June and July.

Housing starts showed their greatest advance in the Northeast, where housing activity has been slack for months. Starts were up 16.0 percent in that region to a seasonally adjusted annual rate of 196 thousand units. However, starts in the Northeast remained 23.1 percent below the 255 thousand unit annual rate of a year ago. The Midwest also experienced a healthy rebound in the rate of starts, rising 11.0 percent to a seasonally adjusted annual rate of 272 thousand units. Starts fell in July in both the South and the West, two regions which had experienced rather strong growth in the rate of starts during June. Starts dropped by 4.3 percent in the South to a seasonally adjusted annual rate of 530 thousand units, and fell 4.2 percent in the West to an annual rate of 432 thousand units.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Jul 1989	739	Dec 1988	669
Jun 1989	646	Nov 1988	650
May 1989	646	Oct 1988	718
Apr 1989	607	Sep 1988	691
Mar 1989	555	Aug 1988	712
Feb 1989	621	Jul 1988	701
Jan 1989	700		

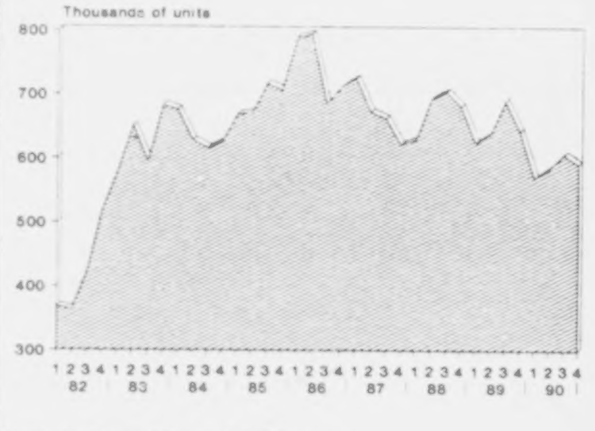
Jul 1989 Changes From:		Annual Totals:	
Jun 1989	14.4%	1987	671
Jul 1988	5.4%	1988	676

REGIONAL DATA

	Northeast	Midwest	South	West
Jul 1989	120	125	261	232
Jun 1989	77	101	255	213
May 1989	88	99	265	195
Apr 1989	82	99	201	182
Mar 1989	107	99	201	148
Feb 1989	84	103	236	198
Jul 1988	100	98	300	214
1988	101	97	276	202
1987	117	97	271	186
Jul 1989 Changes From:				
Jun 1989	55.8%	23.8%	2.4%	8.9%
Jul 1988	15.4%	34.4%	-7.8%	5.0%

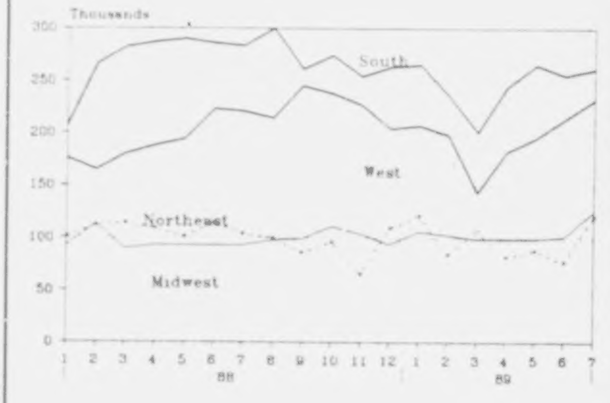
Source: Bureau of the Census, Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source The Bureau of Census, E NAR Estimates

GRAPH 10: NEW HOME SALES BY REGION



Source The Bureau of Census

Sales of new single-family homes staged an impressive comeback in July, jumping 14.4 percent to a seasonally adjusted annual rate of 739 thousand units. The rise marked the fastest rate of sales since December 1986, when homes were sold at an annual rate of 768 thousand units; and it was also the largest one month climb since March 1986. The July rebound appears to be the direct effect of a surge in market activity in both the Northeast and Midwest regions. New home sales have been exceptionally sluggish in the Northeast for months. The July fall in interest rates and diminishing fears of a recession, spurred the 55.8 percent jump in sales in the Northeast, and encouraged a 23.8 percent increase in the Midwest. For the Northeast, the 120 thousand unit annual rate was 15.4 percent faster than a year ago and faster than any rate seen since November of 1987. In the Midwest, the 125 thousand unit annual rate was 34.4 percent faster than a year ago, and the quickest pace since February 1987. Sales in the West moved up 8.9 percent to a seasonally adjusted annual rate of 232 thousand units, marking the fourth consecutive monthly rise, putting sales in that region 5.0 percent above the rate of a year ago. In the South, sales rose 2.4 percent to an annual rate of 261 thousand units. However, sales have been comparatively slow in the South during 1989: July sales were down 7.8 percent from July 1988.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Jul 1989	3400	Dec 1988	3920
Jun 1989	3360	Nov 1988	3710
May 1989	3210	Oct 1988	3680
Apr 1989	3400	Sep 1988	3650
Mar 1989	3400	Aug 1988	3690
Feb 1989	3480	Jul 1988	3650
Jan 1989	3550		

Jul 1988 Changes From:		Annual Totals:	
Jun 1989	1.2%	1988	3594
Jul 1988	-6.8%	1987	3526

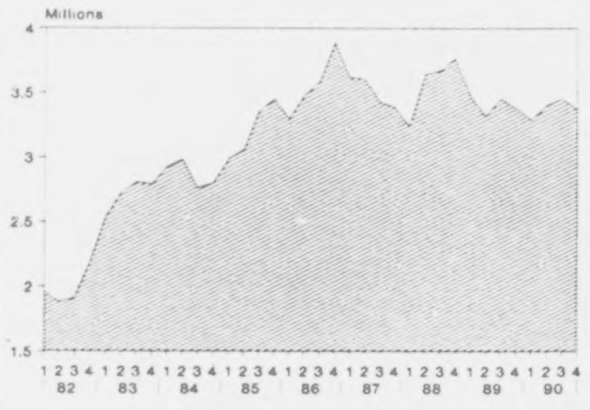
REGIONAL DATA

	Northeast	Midwest	South	West
Jul 1989	560	910	1320	570
Jun 1989	510	960	1280	600
May 1989	610	810	1230	580
Apr 1989	610	890	1280	620
Mar 1989	570	870	1270	670
Feb 1989	600	920	1310	640
Jan 1989	710	930	1310	630
Jul 1989	690	930	1370	660
1988	673	929	1350	642
1987	685	959	1282	600

Jul 1989 Changes From:				
Jun 1989	9.8%	-5.2%	3.1%	-5.0%
Jul 1988	-18.8%	-2.2%	-3.6%	-13.6%

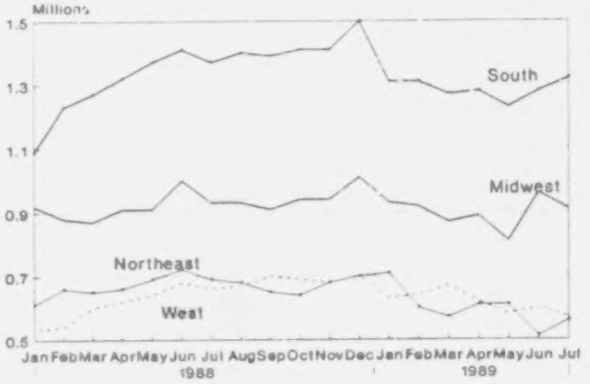
Source: NATIONAL ASSOCIATION OF REALTORS®, Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: The Bureau of Census, E NAR Estimates

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics and Research; E NAR Estimates

Mirroring the trend in starts and new home sales, the sales pace of existing homes picked up speed in July, rising 1.2 percent to a seasonally adjusted annual rate of 3.4 million units. When compared with a year ago, sales were off 6.8 percent from the 3.65 million unit sales rate. The July increase follows a 4.7 percent jump in June, which had put an end to a string of five monthly declines since January of this year. Sales are expected to remain strong in August, as continued low interest rates and new signs of economic growth encourage potential homebuyers. However, it is unlikely that the fall will see any large increase in sales activity given the Fed's apparent goal of keeping a tight reign on inflation. In the second half of 1989, sales are expected to average an annual rate of 3.43 million units, compared with 3.40 million units in the first half.

The increase in existing single-family home sales was led by the Northeast, where the sales rate rose 9.8 percent in July, after falling 16.4 percent in June (the Northeast was the only region to experience a decline in sales during June). However, sales in that region were 18.8 percent below their pace of a year ago. In the Midwest, sales declined 5.2 percent to a seasonally adjusted annual rate of 910 thousand units, down 2.2 percent from a year ago. Sales in the South rose for the second consecutive month to an annual rate of 1.32 million units, the fastest rate in that region since December of last year. Sales in the West were down 5.0 percent to a seasonally adjusted annual rate of 570 thousand units, marking the slowest rate of sales in over 16 months, and 13.6 percent below the sales pace of a year ago.

SINGLE-FAMILY HOME PRICES

	Median		Average	
	Existing	New	Existing	New
Jul 1989	$96,400	$118,800	$121,200	$143,300
Jun 1989	93,400	123,400	118,800	155,500
May 1989	92,600	118,900	118,000	144,800
Apr 1989	92,900	116,700	118,000	144,700
Mar 1989	92,000	123,000	116,100	149,000
Jul 1988	$90,700	$118,000	$114,700	$141,300
1988	89,300	112,500	112,800	138,300
1987	85,600	104,500	106,300	127,200
Jul 1989 Changes From:				
Jun 1989	3.2%	-3.7%	2.0%	-7.8%
Jul 1988	6.3%	0.6%	5.7%	1.4%

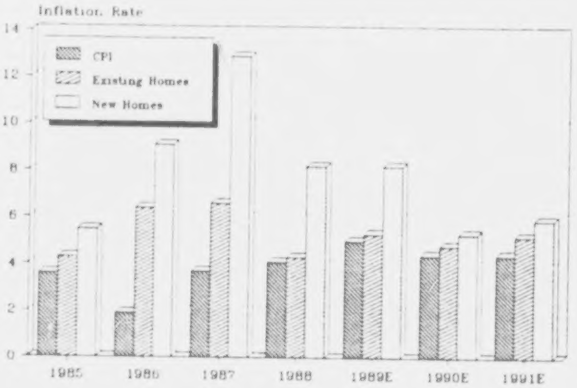
REGIONAL DATA

MEDIAN SALES PRICE OF AN EXISTING HOME

	Northeast	Midwest	South	West
Jul 1989	$147,900	$73,500	$88,200	$138,200
Jun 1989	149,900	72,000	85,000	134,500
May 1989	143,800	70,300	84,100	142,300
Apr 1989	144,000	70,400	85,200	142,700
Mar 1989	143,600	69,900	84,000	138,000
Jul 1988	$144,700	$69,400	$84,700	$125,300
1988	143,000	68,400	82,200	124,900
1987	133,300	66,000	80,400	113,200
Jul 1989 Changes From:				
Jun 1989	-1.9%	2.1%	3.7%	2.7%
Jul 1988	2.2%	5.9%	4.1%	10.3%

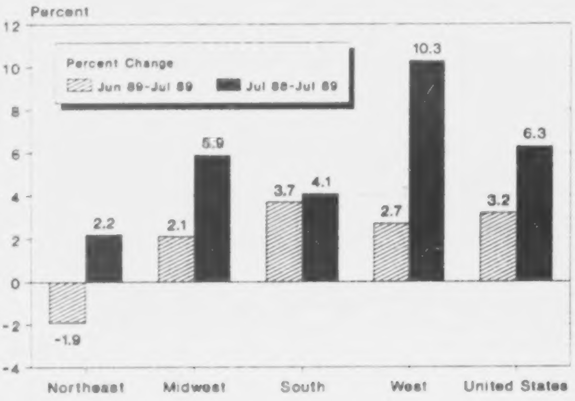
Source: NATIONAL ASSOCIATION OF REALTORS®, Economics and Research Division

GRAPH 13: HOME PRICES



Source: The Bureau of Census, E NAR Estimates

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics and Research, E NAR Estimates

As is usually the case during the summer months, the median price of an existing single-family home continued to rise in July, moving upward by 3.2 percent to $96,400. Moreover, the median existing home showed an annual appreciation rate (July 1988 to July 1989) of 6.3 percent. Meanwhile, the median price of a new home dropped 3.7 percent in July to $118,800 and was virtually unchanged from the $118,000 median price of a year ago. The rapid price acceleration in new homes since 1986, appears to be subsiding somewhat. The surge in the price of new homes has been encouraged by increases in both size and amenities, as the first wave of the baby boomers matured into the "move-up" market and demanded bigger and better homes. While the demand for large homes is likely to remain strong in coming years, it is unlikely that potential buyers will continue to demand *increasingly* larger homes. Consequently, we expect that increases in new home prices will fall more in line with that of existing home prices in coming years.

The Northeast was the only region to see a decline in the median price of an existing single-family home during June, where prices fell 1.9 percent to $147,900. The South experienced the largest one month price increase, with the median price moving up 3.7 percent to $88,200. Meanwhile, prices in the West and Midwest were up 2.1 percent and 2.7 percent, respectively.

Sean A. Burns, Director of Forecasting
Beth M. Maerz, Research Associate

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

U.S. ECONOMIC OUTLOOK SEPTEMBER 1989

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	1989.1	1989.2	1989.3	1989.4	1990.1	1990.2	1990.3	1990.4	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5113	5204	5279	5355	5434	5504	5577	5655	4524	4881	5238	5543	5898
% Change	7.9	7.3	5.9	5.9	6.0	5.3	5.4	5.7	6.9	7.9	7.3	5.8	6.4
% Change (w/out inflation)	3.7	2.7	2.1	1.8	1.5	1.4	1.5	1.9	3.7	4.4	2.9	1.7	2.3
Consumer Price Inflation (CPI)	5.4	6.4	3.6	4.4	4.3	4.4	4.3	4.2	3.7	4.1	5.0	4.4	4.4
GNP Inflation (GNP Deflator)	4.0	4.6	3.6	4.0	4.4	3.9	3.8	3.7	3.1	3.3	4.3	4.0	4.0
Unemployment Rate - Civilian	5.2	5.3	5.2	5.2	5.3	5.3	5.4	5.5	6.2	5.5	5.2	5.4	5.3
Civilian Employment-Household Basis (millions)	116.9	117.3	117.8	118.2	118.4	118.8	119.0	119.3	112.4	115.0	117.6	118.9	120.4
Percent change	3.7	1.3	1.8	1.4	0.7	1.1	0.9	1.0	2.6	2.3	2.3	1.1	1.3
Index of Industrial Production	140.7	141.6	142.3	142.9	143.5	143.9	144.5	145.2	129.8	137.2	141.9	144.3	147.9
Manufacturing Capacity Utilization	84.4	84.2	84.0	83.9	84.0	83.9	83.8	84.2	81.0	83.6	84.1	84.0	84.0
Domestic Auto Sales	7.0	7.3	7.9	7.0	7.0	7.0	7.2	7.3	7.1	7.5	7.3	7.1	7.3
Federal Tax Receipts (NIPA) as % of GNP	20.3	20.2	20.0	20.1	20.8	20.8	20.9	20.9	20.1	19.9	20.2	20.8	20.8
Federal Expenditures (NIPA) as % of GNP	23.2	23.1	22.8	22.7	22.8	22.7	22.7	22.6	23.7	22.9	22.9	22.7	22.6
Deficit(NIPA)	-147.5	-148.4	-145.4	-138.0	-106.2	-103.6	-102.5	-101.0	-161.3	-145.9	-144.8	-103.3	-104.8
as % of GNP	-2.9	-2.9	-2.8	-2.6	-2.0	-1.9	-1.8	-1.8	-3.6	-3.0	-2.8	-1.9	-1.8
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4515	4285	4493	4425	4309	4418	4478	4388	4648	4650	4429	4398	4458
Percent change -- year ago	1.5	-2.0	-3.8	-5.7	-4.6	3.1	-0.3	-0.8	-1.4	0.0	-4.7	-0.7	1.4
Existing Single-family Home Sales (thousands)	3477	3320	3457	3383	3290	3405	3455	3370	3526	3594	3409	3380	3445
Percent change -- year ago	5.4	-8.9	-5.6	-10.3	-5.4	2.6	-0.1	-0.4	-1.1	1.9	-5.1	-0.9	1.9
Housing Starts (thousands)	1517	1357	1461	1465	1439	1440	1451	1446	1634	1495	1450	1444	1431
Percent change -- year ago	2.8	-8.1	-0.4	-6.0	-5.2	6.2	-0.7	-1.3	-9.8	-8.5	-3.0	-0.4	-0.9
Single-Family Units	1070	995	1068	1074	1050	1044	1055	1050	1156	1088	1052	1050	1045
Percent change -- year ago	-2.3	-6.0	0.7	-5.6	-1.8	5.0	-1.2	-2.3	-2.2	-5.9	-3.3	-0.2	-0.5
Multi-Family Units	448	362	393	390	389	396	396	396	477	407	398	394	387
2-4 Family Units	59	53	58	58	57	58	59	59	65	59	57	58	57
Percent change -- year ago	6.0	-7.5	1.6	-11.9	-3.4	9.4	0.9	1.6	-23.0	-9.5	-3.3	1.9	-2.0
5+ Family Units	388	308	335	333	331	337	338	338	412	348	341	336	330
Percent change -- year ago	19.2	-14.5	-4.1	-6.3	-14.7	9.4	0.9	1.6	-24.4	-15.6	-1.9	-1.4	-2.0
New Single-family Home Sales (thousands)	625	638	690	643	570	585	607	592	671	677	649	589	639
Percent change -- year ago	0.6	-8.5	-1.6	-5.3	-8.8	-8.3	-12.0	-7.9	-10.5	0.9	-4.1	-9.3	8.6
Mobile Homes Shipped (thousands)	217	202	214	215	208	210	209	212	233	218	212	210	216
HOME PRICES													
Existing Home Prices - Median $(1000)	91.2	92.9	95.4	96.5	97.2	98.0	99.3	99.7	85.6	89.3	94.0	98.6	103.7
Percent change -- year ago	3.9	4.5	5.8	8.8	6.6	5.5	4.1	3.3	6.6	4.3	5.3	4.8	5.2
New Home Prices - Median $(1000)	118.0	122.2	122.5	124.1	124.7	127.2	129.5	131.0	104.0	112.5	121.7	128.1	135.7
Percent change -- year ago	4.5	8.2	6.6	8.1	5.7	4.1	5.7	5.6	13.0	8.2	8.2	5.3	5.9
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.9	10.5	10.0	9.9	10.0	9.9	9.8	9.7	10.2	10.5	10.3	9.9	10.1
1-year ARM (without buydown)	8.8	9.0	8.7	8.5	8.5	8.5	8.5	8.5	8.5	8.5	8.8	8.5	8.5
Corporate AAA Bond Rate	9.7	9.5	9.0	8.9	9.0	8.9	8.8	8.7	9.4	9.7	9.3	8.9	9.0
Government Bond Rate	9.0	8.7	8.2	8.1	8.2	8.1	8.1	8.0	8.6	9.0	8.5	8.1	8.3
Short-Term Interest Rates													
Federal Funds Rate	9.4	9.7	9.1	8.8	8.5	8.2	8.2	8.2	6.7	7.6	9.3	8.3	8.0
3-month T-Bill Rate	8.5	8.4	8.0	7.8	7.6	7.4	7.4	7.4	5.8	6.7	8.2	7.5	7.2
Prime Rate	11.0	11.4	10.8	10.6	10.5	10.0	10.0	10.0	8.2	9.3	11.0	10.1	10.0
Discount Rate	6.7	7.0	7.0	7.0	6.7	6.5	6.5	6.5	5.7	6.2	6.9	6.5	6.2
Value of the U.S. Dollar (Trade-Weighted Avg.)	96	100.4	100.2	100.1	98.3	96.4	94.7	93.8	96.9	92.8	99.2	95.8	92.6
Percent change	13.5	19.7	-0.5	-0.6	-6.9	-7.8	-6.6	-3.7	-13.6	-4.3	6.9	-3.4	-3.3

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz.

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P7000-1

Vol. 2, No. 10

October 1989

REAL ESTATE OUTLOOK

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The aggregate measure of the nation's economic activity, the Gross National Product, advanced at a 2.5% annual rate in the second quarter of 1989, 0.2 percentage points slower than originally estimated by the Commerce Department. Downward revisions to consumption and government spending were only partially offset by upward revisions to trade and investment.
- Data on production in the current quarter is mixed, with many indicators suggesting the economy may have grown stronger for a brief period in the summer. Fears of a recession beginning in 1989, seem to have faded.
- The producer price index for finished goods fell 0.4 percent in August, a repeat of the July report. Most of the plunge in prices is due to much lower energy prices. For the first eight months of 1989, consumer prices have advanced at a 4.8 percent annual rate, compared to a 4.4 percent rise for the same period in 1988.
- Starts of privately owned housing units plunged 5.0 percent in August, to an annual rate of 1.353 million units, and were 7.3 percent below their August 1988 annual rate of 1.459 million units. Single-family starts fell to 1.003 million units, down 2.5 percent from the July 1989 annual rate of 1.029 million units, and 6.8 percent below their August 1988 annual rate of 1.076 million units.
- The pace of new single-family home sales was virtually unchanged in August at an annual rate of 755 thousand units. The August rate was a full 6.0 percent higher than the August 1988 rate.
- Existing single-family home sales rebounded in August to an annual rate of 3.44 million units, 3.3 percent above the July revised annual rate of 3.33 million units. August existing home sales were down 6.8 percent from the 3.69 million unit annual rate of August 1988.
- The median existing single-family home price declined in August to $94,900, off 1.9 percent from the July median price of $96,700. However, on a year-over-year basis, the August 1989 median price was 3.7 percent higher than the August 1988 median price of an existing home.

IN THIS ISSUE

NATIONAL ASSOCIATION OF REALTORS®
REALTOR®
The Voice for Real Estate™

Forecasting & Policy Analysis Division
NATIONAL ASSOCIATION OF REALTORS ®
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GIMME SHELTER:

Economic Commentary

by
John A. Tuccillo
Chief Economist and
Senior Vice President
Real Estate Finance

The storm is threatenin'
My very life today
If I don't get some shelter
I'm gonna fade away.
Oh, Children
It's just a shout away ...

Well, the epitaph for homeownership has been written yet again. In what is becoming a steady stream of journalistic and semi-scholarly opinion on the prospects for housing markets and homeownership, there is a growing sentiment among commentators that the Nineties will be a decade of collapsing home values and falling homeownership rates. These commentaries should be taken seriously but not too seriously. George Will once commented, on the occasion of the Greenspan Commission report on the Social Security System in 1983, "Every five years or so, we fix Social Security for the next fifty years." So too with homeownership: its death knell has been rung so often that the bell is worn out.

The public pessimism about housing and homeownership stems from two distinct roots. The first of these is the decline in homeownership rates that occurred during the Eighties, and, more specifically, the drastic fall in the rate for young households. In part, this is cultural: young households formed at later ages, wed later, bore children later and sought homeownership later. In part, the decline represented the affordability problem facing first-time buyers particularly in higher cost markets. The run-up of home prices relative to incomes in those markets left a hangover of frustrated would-be owners trying to clear a formidable downpayment barrier. The net result of both these forces was a nine percentage point decline in the homeownership rate for young households, a figure responsible for virtually all the decline in the national rate this decade.

But if the past provides one seed of pessimism, the future contributes yet another. After the baby boom generation passes from the scene, a much smaller population group takes its place. And simple extension of that fact suggests a falling demand for houses and declines in housing values. While this is a bit simplistic, it has gained great currency lately due to a study put out by the respected National Bureau of Economic Research. Clearly, while there may be little fire, there certainly is a lot of smoke.

I think it's necessary to blow away some of the smoke and take a look at the real state of housing, present and future. First, the bad news. Young households living in high cost markets have been largely shut out of the housing opportunities that were within the reach (with some effort) of their elders. In short, there is an affordability problem that affects thousands of young families. Moreover, by the turn of the century there will be fewer households seeking to become homeowners. Up to this point, I am in complete agreement with the housing pessimists.

Now for a different interpretation of these facts. It says here that, while the housing sector heads into a long downturn around the turn of the century, the Nineties ought to be a banner decade for the industry. Why?

1. The boomers are aging (I). As they age, they will increase their savings. Together with the shrinking (in terms of GNP) Federal deficit and the build-up of the Social Security trust fund, this will push interest rates down over the next five to seven years.

2. The boomers are aging (II). Those who have been locked out of homeownership will find the door opening as they grow older. The leading edge of the baby boom, moving through peak earning years, will provide increased demand for second homes, usually with an eye toward retirement.

3. The busters are lucky. Yes, there are fewer people in the post-1964 generation. But that means a brighter economic future. In the Eighties, people in the 18-25 year old age group lost nearly a third of their purchasing power. In the Nineties, folks of the same age group will gain that back. Their housing behavior will be more effective than a simple projection of household numbers would lead you to expect.

Please be careful. As good as the Nineties look, a cliff looms at the end. As we move to the 21st Century demand for housing will slow, and shift to smaller units in sunny climates. And REALTORS® need to plan not only to profit from the good years, but to prepare for the not good. In a sense, we're heading into the fulfillment of the old gypsy curse, "May you live in interesting times." Or, as more modern philosophers would put it:

You can't always get what you want.
But if you try
Sometimes you might find
You get what you need.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

The aggregate measure of the nation's economic activity, the Gross National Product, advanced at a 2.5% annual rate in the second quarter of 1989, 0.2 percentage points slower than originally estimated by the Commerce Department. Downward revisions to consumption and government spending were only partially offset by upward revisions to trade and investment. Profits from current production were also revised downward, by $1.3 billion, marking an $8.5 billion slide in addition to the first quarter's $23.9 billion drop. Profits after tax fell $12.1 billion following a $2 billion drop in the opening quarter of 1989. Data on production in the current quarter is mixed, with many indicators suggesting the economy may have grown stronger for a brief period in the summer. Fears of a recession beginning in 1989, seem to have been proven unfounded, lending more credence to the notion of a soft landing after several years of rapid economic growth. This soft landing is expected to bring below trend economic growth (real GNP advances below 2.5 percent), moderating rates of inflation, and declining interest rates through the end of next year.

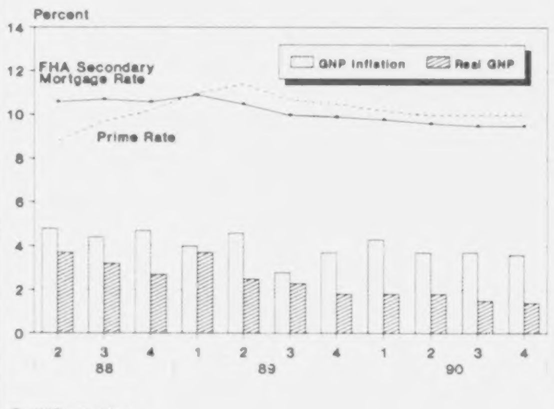
Summer Heat ...

One indicator that suggested the economy was picking up steam again was the August report on new factory orders. In that Commerce Department report, factory orders shot up 2.9 percent during the month to $237.2 billion, after having dropped 2.0 percent in July. A principal source of the surge came from a strong rise in automobile bookings as dealers requisitioned 1990 models. But the heat was on in other industries as well, as new factory orders for a wide variety of industrial goods poured in. This report suggested that the economy's manufacturing sector could be emerging from a few months in the economic doldrums. A particularly important component of the report, orders for non-defense capital goods, rose by 4.9 percent (after excluding a drop in civilian aircraft bookings). However, the overall increase in factory orders was not enough to forestall the first drop in unfilled orders in over two and a half years.

...Followed by a Cooler Fall?

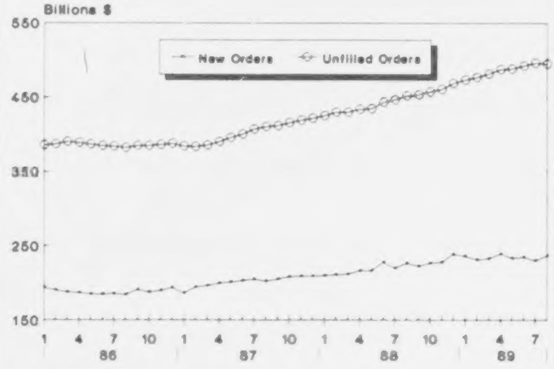
More recently, the economy appears to be sliding back from its aggressive growth posture of the summer months. For example, a September survey of the nation's purchasing managers, despite edging slightly higher in September, continues to point to a general decline in manufacturing. Specifically, the overall index rose to 46 percent in September, from 45.2 percent in August. Next to the August reading, the index is currently at its lowest level since December 1982. Generally, index readings below 50 percent indicate a decline in the economy, while those above 50 percent suggest an expansion. September data on consumer confidence as reported in a Conference Board index, shows no strong increase, but rather a leveling off at near historic highs. That index was 115.4 in both September and August, while the September 1988 reading was at 110.7. However, an appraisal of the current economic situation was weaker in September than in August, and expectations of future economic conditions were mixed.

GRAPH 1: THE ECONOMIC OUTLOOK



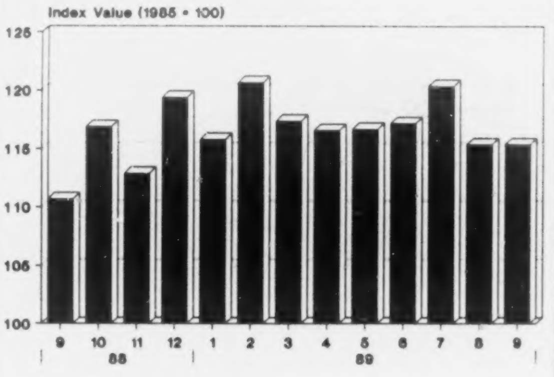
E NAR estimates.

GRAPH 2: FACTORY ORDERS ADVANCE



Source Department of Commerce

GRAPH 3: CONFIDENCE LEVELS OFF



Source: Conference Board

Slower Growth Stalls Inflation?

Indicators of cooler economic growth have recently been followed by brighter news on the inflation front. For example, the producer price index for finished goods fell 0.4 percent in August, a repeat of the July report. Most of the plunge in prices is due to much lower energy prices. During August, energy prices plummeted 7.3 percent, setting the producer price index up for its third consecutive monthly decline. Calm fell upon the consumer price front as well, where in August the consumer price index remained unchanged from its July level. The index was restrained by lower prices for gasoline and in the apparel and upkeep component. This was the third straight month in which energy price declines affected the index. But all is not really so quiet on the inflation front. Both producer prices and consumer prices actually advanced in August, if the effects of lower energy and food prices are netted out: producer prices for finished goods excluding food and energy products advanced 0.5 percent; and a similar measure shows consumer prices advanced 0.2 percent. For the first eight months of 1989, consumer prices have advanced at a 4.8 percent annual rate, compared to a 4.4 percent rise for the same period in 1988.

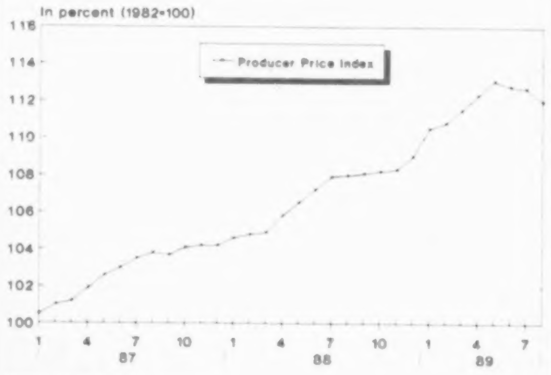
Export Boom Unaffected by Slower Growth

Despite the makings of slower growth in domestic output, and a stubbornly strong dollar, the U.S. trade deficit continues to improve, aiding the fortunes of America's export businesses. So far in 1989, the value of the dollar relative to other industrial countries has risen about 10 percent. Typically, such a rise could be expected to dampen demand for U.S. exports as they become more expensive with a stronger dollar. Instead, the export boom continues, and slower economic growth at home is making U.S. consumers shy away from expensive imported goods: the combined result is a shrinking trade deficit. The deficit fell to $7.6 billion in July, from $8.0 billion in June, and was the smallest trade gap since December 1984. The July report showed imports declining 2.5 percent, and exports slipping only 1.8 percent. Monthly swings in exports and imports are common, making no one figure worthy of extrapolating into a trend. The upshot is simple: despite greater international confidence in the U.S. dollar (resulting in a rise in its value during 1989), the value of the dollar is much lower than its 1985 peak and will likely contribute to steady, long-term improvement in the trade deficit through strong export growth, and slowing import purchases.

New Construction Spending Rises

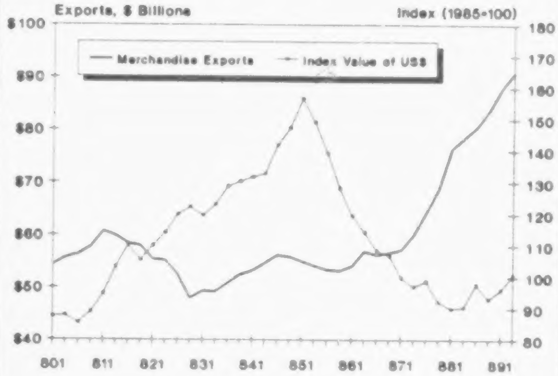
After posting two monthly declines, spending on new construction increased 1.8 percent in August, according to a Commerce Department report. Construction spending reached an annual rate of $421.8 billion in August, after slipping 0.6 percent in July and 0.8 percent in June. However, the increase was based mainly in spending on public projects, while spending for private residential projects fell slightly. After netting out the effects of inflation, construction spending increased 0.7 percent in August over the July annual rate, but was 0.6 percent below the inflation-adjusted August 1988 annual rate.

GRAPH 4: PRICES ARE FALLING



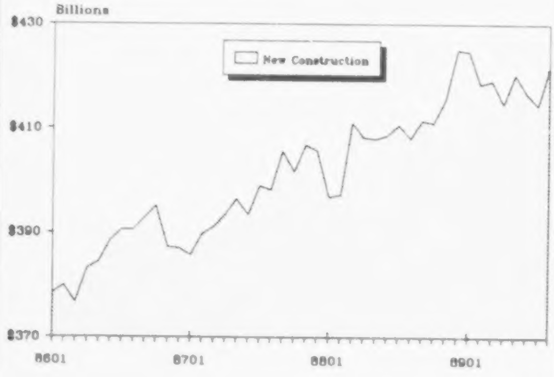
Source: Department of Commerce

GRAPH 5: DOLLAR UP, TRADE GAP SHRINKS



Source: U.S. Bureau of Census; Federal Reserve Board

GRAPH 6: CONSTRUCTION SPENDING UP



Source: Department of Commerce

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

		Total	S-F	2-4	5 and up
Aug	1989	1353	1003	58	292
Jul	1989	1424	1029	57	338
Jun	1989	1406	972	55	379
May	1989	1308	977	42	289
Apr	1989	1343	1029	62	252
Aug	1988	1459	1076	59	324

Aug 1989
Changes From (%):

		Total	S-F	2-4	5 and up
Jul	1989	-5.0	-2.5	1.8	-13.6
Aug	1988	-7.3	-6.8	-1.7	-9.9

REGIONAL DATA

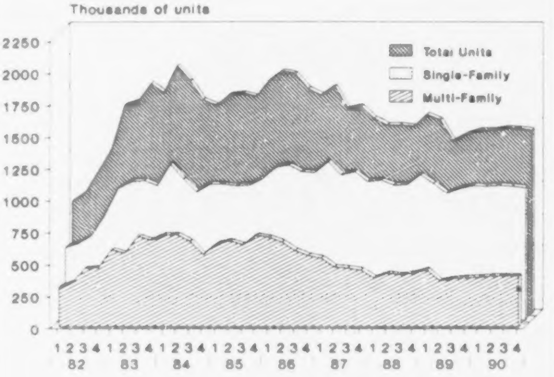
		Northeast	Midwest	South	West
Aug	1989	140	241	574	398
Jul	1989	195	267	532	430
Jun	1989	168	242	552	444
May	1989	176	244	513	375
Apr	1989	207	274	526	336
Aug	1988	217	239	573	430

Aug 1989
Changes From (%):

		Northeast	Midwest	South	West
Jul	1989	-28.2	-9.7	7.9	-7.4
Aug	1988	-35.5	0.8	0.2	-7.4

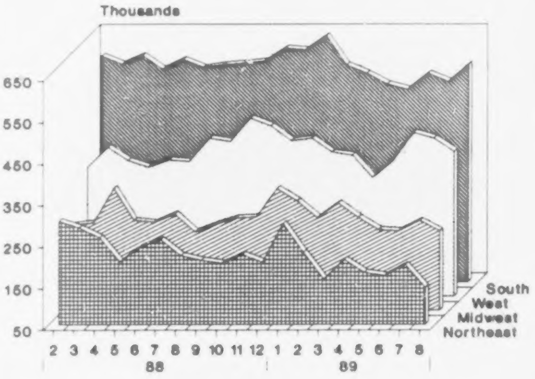
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 8: HOUSING STARTS BY REGION



Source: Bureau of Census

Starts of privately owned housing units plunged 5.0 percent in August, to an annual rate of 1.353 million units. The fall was the steepest since February, and total starts were 7.3 percent below their August 1988 annual rate of 1.459 million units. Single-family starts fell to 1.003 million units, down 2.5 percent from the July 1989 annual rate of 1.029 million units, and 6.8 percent below their August 1988 annual rate of 1.076 million units. It was the third monthly decline in the rate of single-family starts in the last four months. Starts of structures with 2 to 4 units rose for the third consecutive month, climbing to an annual rate of 58 thousand units in August, 1.8 percent above the July 1989 annual rate of 57 thousand units, but 1.7 percent below the August 1988 rate of 59 thousand units. Starts of structures with five or more units retreated to an annual rate of 292 thousand units, off 13.6 percent from the July annual rate of 338 thousand units, and down 9.9 percent from August 1988.

By region, only the South registered an increase in the annual rate of total starts, where they rose by 7.9 percent. In the Northeast, the trend in housing starts is still weak, where total starts reached an annual rate of 140 thousand units, down 35.5 percent from the August 1988 rate of 217 thousand units. In the Midwest, starts fell to an annual rate of 241 thousand units, down 9.7 percent from July 1989, but up 0.8 percent from August 1988. In the West, the August start pace fell 7.4 percent to 398 thousand units, 7.4 percent below August 1988.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Aug 1989	755	Jan 1989	700
Jul 1989	758	Dec 1988	669
Jun 1989	653	Nov 1988	650
May 1989	653	Oct 1988	718
Apr 1989	607	Sep 1988	691
Mar 1989	555	Aug 1988	712
Feb 1989	621		

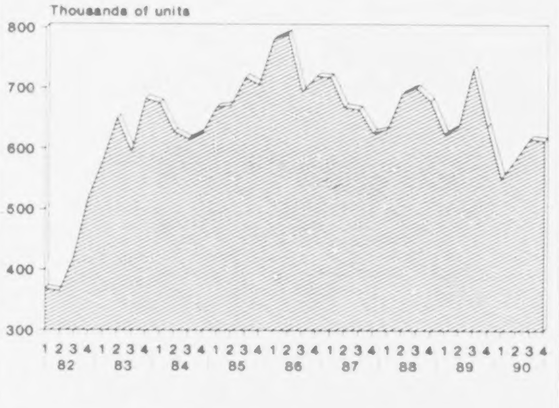
Aug 1989 Changes From:		Annual Totals:	
Jul 1989	-0.4	1987	671
Aug 1988	6.0	1988	676

REGIONAL DATA

	Northeast	Midwest	South	West
Aug 1989	107	93	310	244
Jul 1989	108	129	292	229
Jun 1989	72	102	261	218
May 1989	89	99	271	195
Apr 1989	82	99	244	182
Mar 1989	107	99	201	143
Aug 1988	100	98	300	214
1988	102	97	276	202
1987	117	97	271	186
Aug 1989 Changes From:				
Jul 1989	-0.9	-27.9	6.2	6.6
Aug 1988	7.0	-5.1	3.3	14.0

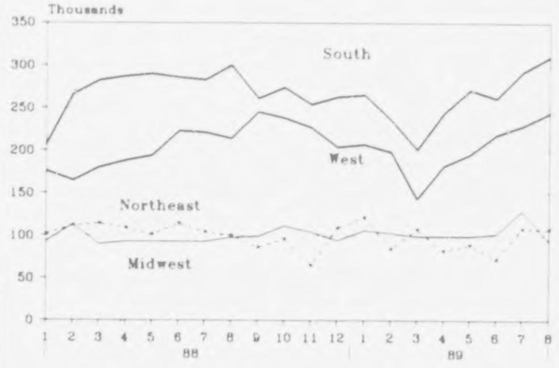
Source: Bureau of the Census; Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 10: NEW HOME SALES BY REGION



Source: Bureau of Census

In a somewhat surprising show of strength, the pace of new single-family home sales was virtually unchanged in August at an annual rate of 755 thousand units. The rapid sales rate in August followed an even better July, when new single-family home sales were sold at an annual rate of 758 thousand units. The August rate was a full 6.0 percent higher than the August 1988 rate. In addition, while the new home sales rate slipped 0.4 percent from the July pace, the August 1989 rate was 15.6 percent above the June 1989 rate. Allowing that new home sales estimates are often given to large revisions, this report suggests that recently lower interest rates have breathed some life back into housing, now that it has weathered the steady rise in rates from early 1988 through March 1989.

By region, the South and the West were the only two regions to post increases in the annual rate of new home sales. In the South, home sales advanced 6.2 percent in August to an annual rate of 310 thousand units, 3.3 percent above the August 1988 rate. In the West, home sales rose 6.6 percent in August to an annual rate of 244 thousand units, and 14.0 percent above the August 1988 rate. In the Northeast, new home sales were virtually unchanged, falling 0.9 percent to an annual rate of 107 thousand units in August, but 7.0 percent higher than their August 1988 pace. In the Midwest, new home sales were down 27.9 percent to an August annual rate of 93 thousand units, and down 5.1 percent from August 1988.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Aug	1989	3440	Jan	1989	3550
Jul	1989	3330	Dec	1988	3920
Jun	1989	3360	Nov	1988	3710
May	1989	3210	Oct	1988	3680
Apr	1989	3400	Sep	1988	3650
Mar	1989	3400	Aug	1988	3690
Feb	1989	3480			

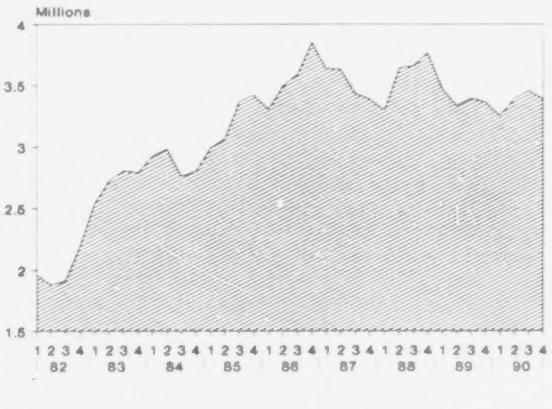
Aug 1989 Changes From (%):			Annual Totals:	
Jul	1989	3.3	1988	3594
Aug	1988	-6.8	1987	3526

REGIONAL DATA

		Northeast	Midwest	South	West
Aug	1989	590	950	1350	550
Jul	1989	550	910	1300	570
Jun	1989	510	960	1280	600
May	1989	610	810	1230	580
Apr	1989	610	890	1280	620
Mar	1989	570	870	1270	670
Aug	1988	680	930	1400	670
	1988	673	929	1350	642
	1987	685	959	1282	600
Aug 1989 Changes From (%):					
Jul	1989	7.3	4.4	3.8	-3.5
Aug	1988	-13.2	2.2	-3.6	-17.9

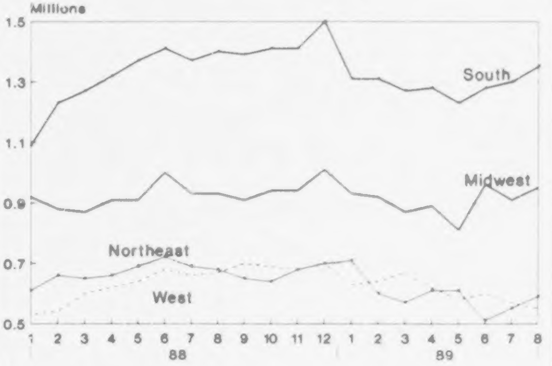
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: NAR Economics & Research; Real Estate Outlook forecast

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics & Research

Existing single-family home sales rebounded in August to an annual rate of 3.44 million units, 3.3 percent above the July revised annual rate of 3.33 million units. August existing home sales were down 6.8 percent from the 3.69 million unit annual rate of August 1988. The July-August 1989 increase raised the pace of existing home sales to their highest rate since February of this year, and increased the average annual rate of existing home sales so far in 1989 to 3.396 million units.

By region, existing home sales advanced in every region but in the West. In that region, existing home sales fell to an annual rate of 550 thousand units in August, down 3.5 percent from the July annual rate of 570 thousand units, and 17.9 percent below the August 1988 annual rate of 670 thousand units. In the Northeast, existing home sales advanced 7.3 percent to an August annual rate of 590 thousand units, but down 13.2 percent from the August 1988 annual rate of 680 thousand units. In the Midwest, existing homes were sold at an annual rate of 950 thousand units during August, an increase of 4.4 percent over the July rate of 910 thousand units, and 2.2 percent higher than the August 1988 annual rate of 930 thousand units. In the South, existing home sales advanced 3.8 percent to reach an annual rate of 1.350 million units in August, but registered a decline of 3.6 percent from the August 1988 annual rate of 1.4 million units.

SINGLE-FAMILY HOME PRICES

(In Dollars)

NATIONAL DATA

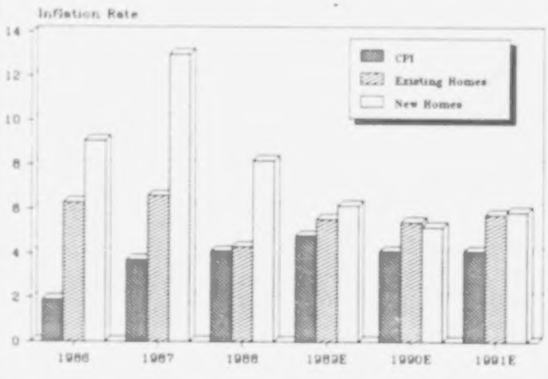
	Median Existing	Median New	Average Existing	Average New
Aug 1989	94,900	122,900	120,700	162,300
Jul 1989	96,700	116,000	122,100	141,600
Jun 1989	93,400	123,000	118,800	153,800
May 1989	92,600	119,000	118,000	145,100
Apr 1989	92,900	116,700	118,000	144,700
Aug 1988	91,500	110,000	115,400	140,600
1988	89,300	112,500	112,800	138,300
1987	85,600	104,500	106,300	127,200
Aug 1989 Changes From (%):				
Jul 1989	-1.9	5.9	-1.1	14.6
Aug 1988	3.7	11.7	4.6	15.4

REGIONAL DATA

	Northeast	Midwest	South	West
Aug 1989	148,400	72,300	87,400	139,400
Jul 1989	147,100	73,400	87,200	146,500
Jun 1989	149,900	72,000	85,000	134,500
May 1989	143,800	70,300	84,100	142,300
Apr 1989	144,000	70,400	85,200	142,700
Aug 1988	148,400	69,800	83,400	126,900
1988	143,000	68,400	82,200	124,900
1987	133,300	66,000	80,400	113,200
Aug 1989 Changes From (%):				
Jul 1989	0.9	-1.5	0.2	-4.8
Aug 1988	0.0	3.6	4.8	9.9

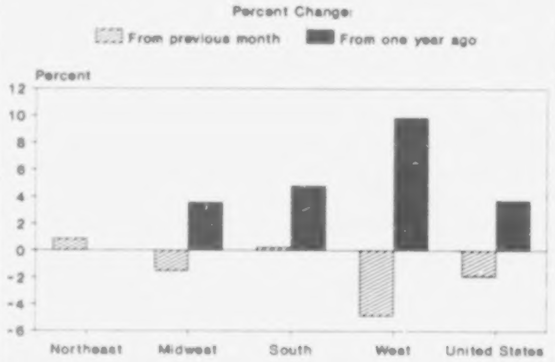
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 13: HOME PRICES



Source: Bureau of Census; E Real Estate Outlook forecast

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics & Research; Real Estate Outlook forecast

Despite an increase in the pace of existing single-family home sales, the median existing single-family home price declined in August to $94,900, off 1.9 percent from the July median price of $96,700. However, on a year-over-year basis, the August 1989 median price was 3.7 percent higher than the August 1988 median price of an existing home. New home prices continued their pattern of wild monthly swings, as the median price of a new home rose 5.9 percent in August to $122,900, but remained below the June 1989 median price of $123,000. The median price of a new home sold in August was 11.7 percent higher than that of a new home sold in August 1988.

By region, existing home prices moved down by 4.8 percent in the West to $139,400, but up 9.9 percent from the August 1988 level. In the Midwest, the median price of an existing home fell 1.5 percent in August to $72,300, but up 3.6 percent from the August 1988 level. In the South, the median price rose 0.2 percent to $87,400, but was 4.8 percent higher than the August 1988 level. In the Northeast, existing home prices rose 0.9 percent in August 1989, to $148,400, but were unchanged from the year ago period.

Sean A. Burns
Director of Forecasting

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

U.S. ECONOMIC OUTLOOK

OCTOBER 1989

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	1989.1	1989.2	89.3	89.4	90.1	90.2	90.3	90.4	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5113	5202	5268	5340	5421	5495	5566	5636	4524	4881	5231	5529	5865
% Change	7.9	7.1	5.2	5.6	6.2	5.6	5.3	5.1	6.9	7.9	7.2	5.7	6.1
% Change (w/out inflation)	3.7	2.5	2.3	1.8	1.8	1.8	1.5	1.4	3.7	4.4	2.9	1.8	2.2
Consumer Price Inflation (CPI)	5.4	6.4	2.5	3.9	4.2	4.2	4.2	4.1	3.7	4.1	4.8	4.1	4.1
GNP Inflation (GNP Deflator)	4.0	4.6	2.8	3.7	4.3	3.7	3.7	3.6	3.1	3.3	4.1	3.8	3.8
Unemployment Rate - Civilian	5.2	5.2	5.2	5.2	5.3	5.4	5.4	5.5	6.2	5.5	5.2	5.4	5.5
Civilian Employment-Household Basis (millions)	116.9	117.3	117.7	118.0	118.3	118.6	118.8	119.0	112.4	115.0	117.5	118.7	119.8
Percent change	3.7	1.3	1.4	1.2	0.9	0.8	0.8	0.7	2.6	2.3	2.2	1.0	1.0
Index of Industrial Production	140.7	141.7	142.3	142.9	143.2	143.9	144.4	144.9	129.8	137.2	141.9	144.1	147.5
Manufacturing Capacity Utilization	84.4	84.4	84.0	83.8	83.7	83.6	83.6	83.6	81.0	83.6	84.1	83.6	84.0
Domestic Auto Sales	7.0	7.3	7.6	6.7	6.9	7.0	7.0	7.1	7.1	7.5	7.2	7.0	7.1
Federal Tax Receipts (NIPA) as % of GNP	20.3	20.2	20.0	20.1	20.8	20.8	20.9	20.9	20.1	19.9	20.2	20.9	20.9
Federal Expenditures (NIPA) as % of GNP	23.2	23.0	22.8	22.8	22.8	22.8	22.7	22.7	23.7	22.9	22.9	22.8	22.7
Deficit(NIPA)	-147.5	-145.4	-148.2	-141.6	-109.8	-104.8	-103.1	-103.3	-161.3	-145.9	-145.7	-105.3	-110.0
as % of GNP	-2.9	-2.8	-2.8	-2.7	-2.0	-1.9	-1.9	-1.8	-3.6	-3.0	-2.8	-1.9	-1.9
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4515	4300	4399	4390	4276	4416	4479	4398	4633	4650	4401	4392	4462
Percent change -- year ago	3.5	-7.9	-6.2	-9.9	-5.3	2.7	1.8	0.2	-1.6	0.3	-5.3	-0.2	1.6
Existing Single-family Home Sales (thousands)	3477	3337	3400	3368	3258	3389	3460	3391	3512	3594	3396	3375	3468
Percent change -- year ago	5.4	-8.4	-7.2	-10.7	-6.3	1.6	1.8	0.7	-1.4	2.3	-5.5	-0.6	2.8
Housing Starts (thousands)	1517	1352	1408	1439	1439	1454	1450	1436	1634	1495	1429	1445	1417
Percent change -- year ago	2.8	-8.4	-4.0	-7.7	-5.2	7.5	3.0	-0.2	-9.8	-8.5	-4.4	1.1	-1.9
Single-Family Units	1070	993	1030	1054	1049	1058	1051	1038	1156	1088	1036	1049	1025
Percent change -- year ago	-2.3	-6.2	-2.9	-7.4	-1.9	6.6	2.1	-1.5	-2.2	-5.9	-4.8	1.2	-2.3
Multi-Family Units	448	360	378	385	389	396	400	398	477	407	393	396	392
2-4 Family Units	59	53	56	57	57	58	59	59	65	59	56	58	58
Percent change -- year ago	6.0	-8.1	-2.2	-13.1	-3.2	10.3	5.6	3.5	-23.0	-9.5	-4.7	3.8	-1.0
5+ Family Units	388	307	322	328	332	338	341	340	412	348	336	338	334
Percent change -- year ago	19.2	-15.0	-7.6	-7.6	-14.5	10.2	5.6	3.5	-24.4	-15.6	-3.2	0.3	-1.0
New Single-family Home Sales (thousands)	625	638	733	638	551	584	617	614	673	677	658	592	639
Percent change -- year ago	-0.8	-8.5	4.6	-6.1	-11.8	-8.5	-15.8	-3.7	-9.6	0.5	-2.7	-10.1	8.0
Mobile Homes Shipped (thousands)	217	202	211	214	209	209	208	209	233	218	211	209	215
HOME PRICES													
Existing Home Prices - Median $(1000)	91.2	92.9	95.6	95.7	96.0	97.9	100.9	100.9	84.9	88.9	93.8	98.9	104.6
Percent change -- year ago	3.9	4.5	6.0	7.9	5.2	5.4	5.6	5.4	5.8	4.7	5.6	5.4	5.8
New Home Prices - Median $(1000)	118.0	122.2	120.9	122.5	123.9	127.8	127.9	129.1	104.7	113.9	120.9	127.2	134.7
Percent change -- year ago	4.5	8.2	5.3	6.7	5.0	4.6	5.8	5.4	13.5	8.8	6.2	5.2	5.9
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.9	10.5	10.0	9.9	9.8	9.6	9.5	9.5	10.2	10.5	10.3	9.6	9.9
1-year ARM (without buydown)	8.8	9.0	9.0	9.0	8.8	8.8	8.7	8.5	8.5	8.5	9.0	8.7	9.0
Corporate AAA Bond Rate	9.7	9.5	9.0	8.9	8.8	8.8	8.7	8.7	9.4	9.7	9.3	8.8	8.9
Government Bond Rate	9.0	8.7	8.1	8.1	8.1	7.9	7.7	7.7	8.6	9.0	8.5	7.9	8.2
Short-Term Interest Rates													
Federal Funds Rate	9.4	9.7	9.1	8.8	8.5	8.2	8.1	8.0	6.7	7.6	9.3	8.2	8.1
3-month T-Bill Rate	8.5	8.4	7.8	7.6	7.3	7.1	7.0	7.0	5.8	6.7	8.1	7.1	7.0
Prime Rate	11.0	11.4	10.7	10.5	10.2	10.0	10.0	10.0	8.2	9.3	10.9	10.0	10.0
Discount Rate	6.7	7.0	7.0	7.0	6.8	6.5	6.5	6.5	5.7	6.2	6.9	6.6	6.5
Value of the U.S. Dollar (Trade-Weighted Avg.)	96.0	100.4	102.2	102.4	100.4	98.1	96.0	94.6	96.9	92.8	100.2	97.2	93.2
Percent change	13.5	19.7	7.3	0.8	-7.6	-8.9	-8.2	-5.7	-13.6	-4.3	8.1	-3	-4.1

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy. Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, and Sean Burns.

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